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## Book Reviews

### The American Legal System

By Lewis Mayers. HARPER & BROTHERS  
New York, N. Y., 1955. Pages: ix +  
589; \$6.50.

Professor Mayers here presents a panoramic survey of American Institutions, however styled, which function to hear and decide controversies affecting the rights and obligations of individuals. The court system, state and federal, is the major focus of study, some two-thirds of the volume. An examination of administrative, military and arbitration tribunals, together with their relationship to the court system complete the study. Of necessity in a work so ambitious, presented in a single volume, each subject is given only summary treatment. The whole is presented in a style direct and serviceable.

Part I, which deals with the court system, considers its sources of authority, the constitutional sanction; its historical development including the English heritage and reception; its operational procedures, civil and criminal; its personnel; the interrelationship of federal and state sovereignty and the place of the U. S. Supreme Court; the nature of the judicial process; and its control function over the other governmental branches, the executive and legislative.

Parts II, III and IV examine the jurisdiction, nature, operations and personnel of administrative, military and arbitration tribunals respectively, as well as their relationship to the court system.

The approach is realistic. The work of the various bodies studied and the characteristics and activities of their personnel are described as they actually are and function. The need for improvement in some of these areas is pointed out, current proposals are indicated, and the author's preferences are made clear. The value of this book, however, rests in its descriptive aspects.

*The American Legal System* is valuable to business men and those interested in the judicial process as a general introduction to the subject. It would seem most appropriate as a text for business or liberal arts students. For professional use, however, additional research in any of these areas would be necessary. A useful bibliography is contained in the Appendix.

The perspective which this integrated treatment provides makes Professor Mayers' book an important contribution to the field.

GEORGE C. THOMPSON  
Graduate School of Business  
Columbia University

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## Book Reviews

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### The Law of Accounting

By George S. Hills. Reprinted from *Columbia Law Review*, Vol. 54, January, 1954, pp. 1-53 and November, 1954, pp. 1049-1106.

"Common law," observes the author, a member of the New York Bar, "is not a static concept, but a dynamic and growing force"; "Common Accounting" [is] . . . a harmonious system of rules for recording facts of financial significance." They are, after a fashion, "companionate functionaries in the orderly housekeeping of business and finance."

Mr. Hills studies "the legal concepts . . . derived from judicial decisions and statutory enactments concerning accounting principles and practices . . ." He omits tax accounting problems. The purpose of his work is "to explore and give orderly formulation to the more prominent features of the law of accounting." Accordingly, he presents opinions of "accounting authorities," points up the areas in which they disagree, and tries to reconcile the points of disagreement.

The material reprinted appeared as two *Columbia Law Review* articles, in January and November, 1954, the first paper being devoted to the items in the balance sheet and the second to those making up the income statement.

The author observes that the main analytical difficulties met by the courts and the accounting profession "appear to stem from . . . [the] movement-status distinction," the income statement being "an interim report or installment in the long-term financial history," while the balance sheet "is concerned primarily with financial resources and obligations at a given date." He further points out that:

"In its preoccupation with the immediate equities and rights of stockholders or creditors the law often appears to ignore the concept of movement or continuity, while the accountant, who deals primarily with the continuity of business affairs, tends to emphasize the flow of costs and the interpretation of assets as balances of unamortized costs. . . ."

The 100 pages comprising the two papers are about equally divided between balance sheet and income statement. Approximately 150 notes are provided, including several thousand legal citations. Frequent reference is made to the American Institute of Accountants' *Accounting Research Bulletins*; the Securities and Exchange Commission's *Accounting Series Releases*; Sanders, Hatfield and Moore's *Statement of Accounting Principles*; Montgomery's *Auditing*; Kessner's *Advanced Accounting*; and Bell's *Accountants' Reports*.

(Continued on page 320)

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## **Book Reviews**

(Continued from page 319)

This abstract from Mr. Hills' conclusion merits reflection:

"Common law and accounting share many characteristics. Both must yield to legislative enactment and administrative prescription. . . . Common law is sufficiently malleable to accommodate itself to accounting as an existing fact and practice. Thus the courts will give effect to accounting principles in the interpretation of contractual language where it is evident that the words used are intended to have economic or accounting significance. . . . On the other hand, accounting practices have to be modified in those areas where legal policies and considerations dominate the relevant accounting concepts. . . . The practice of accountancy, no less than that of common law, is a resolute yet facile art. . . .

"It is necessary, in appraising the position of accounting in jurisprudence, to accept the fact that courts function to adjudicate disputes, not to vindicate the arts. . . . Consequently, in some circumstances generally accepted accounting principles will have no higher standing before the courts than principles or practices not so accepted by the accounting profession. . . . In other circumstances, the general acceptance of accounting methods by the accountants . . . or by industry . . . has been cited by the courts as authority in support of accounting methods believed by the court to be consistent with sound practice. . . .

"In most cases law and accounting function cooperatively. . . .

"The courts envisage accounting as an implemental art worthy of judicial recognition where properly and adequately employed to reliably present facts having financial significance. . . . However, where accounting fails to record obvious facts even under a 'sound' system. . . . the courts will cast aside conventional accounting and give effect to the admonition that 'elaborate calculations which are at war with realities are of no avail'. . . ."

This valuable analysis of the law underlying our work as accountants is recommended for study and reference.

LEO ROSENBLUM

Bernard M. Baruch School of  
Business and Public Administration  
The City College of New York

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## Book Reviews

(Continued from page 320)

### Depreciation (Revised Printing)

By Eugene L. Grant and Paul T. Norton, Jr. THE RONALD PRESS COMPANY, New York, N. Y., 1955. Pages: xiv + 504; \$7.50.

Originally published in 1949, the book has been reprinted with an additional chapter and with extensive sum-of-the-years digits tables added to the appendices. Minor changes have been made in the original chapters.

The added chapter discusses over 39 pages the changes in depreciation authorized by the Internal Revenue Code of 1954, and there is an appendix briefly listing excerpts from the 1954 Code. The authors state that the regulations pertaining to the new provision of the Code had not been issued at time of printing; hence, they could not be included.

It is a tribute to the fundamental soundness of the original work that revision could be made merely by the additions of a chapter and some appendices; yet this reader believes the result is not so satisfactory as it might have been if 1954 changes had been integrated into the text of the book.

Part I consists of three chapters that deal with the importance and meaning of depreciation; Parts II and III, representing about 60% of the text, contain the substance of depreciation methods as used for accounting and tax purposes prior to the 1954 Code changes. They contain references to now obsolete tax rates, which, while not important to the conclusions, are distracting to the reader. Part IV has two chapters: one shows the significance of depreciation in the broad economic affairs of a nation; the other, (Chapter 18), makes proposals for needed improvement. Part V, (Chapter 19), is the added chapter that discusses 1954 Code changes.

The 1954 changes in the Code, (Chapter 19), give affirmation to the quality of the proposals for improvements made by the authors in their Chapter 18. Much of what they proposed is represented in the 1954 Code. Yet, this could be a cause of irritation to some readers: to spend time reading what changes are needed, only to learn in the next chapter that there have been later changes that largely satisfy the asserted needs.

In this book, "Depreciation", there is a wealth of scholarly knowledge correlated to practical application. Its basic worth to accountants and financial analysts is abundant, and might be greater if, in the next revision, the authors choose to integrate changes rather than report them in the manner of supplemental amendments.

J. A. DOWLING

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## Book Reviews

(Continued from page 321)

### Practical Distribution Cost Analysis

By Donald R. Longman and Michael Schiff. RICHARD D. IRWIN, INC., Homewood, Illinois, 1955. Pages: v-xii + 450; \$6.50.

This book has been prepared as a reference work and professional aid for accountants, market research men, auditing firms, sales executives and lawyers. Quite obviously the educational background and business experience of each of these groups is somewhat varied, both in the field of marketing and in the field of accounting. To prepare a reference book that would be suitable and useful for persons with such varying backgrounds is not an easy task. Nevertheless a book in the field of distribution costs has become increasingly necessary in recent years owing to the high cost of marketing, and the legal effect of the Robinson-Patman Act.

It has never been clear whether distribution cost analysis falls within the duties of the accountant because of its cost implication, or within the functions of the marketing division, because of its distribution analysis. In fact, deciding whether distribution costs falls within the accounting or the marketing function of a business will frequently indicate whether distribution cost analysis is to be recorded on the books as financial or cost accounting information, or to be treated as a statistical analysis to be prepared by the marketing division of a business firm.

By having two authors of a book on Distribution Cost Analysis—one a director of *marketing research* of a large industrial concern, and the other a *professor of accounting*—the publishers of this text have made a wise selection. The resulting publication represents the best thinking and practice in the field of distribution costs, with a careful analysis of the contributions made by the accountant on the one hand and the market analyst on the other.

This book is divided into five parts:

I Accounting as a Tool of Management

II Introduction to Distribution Costs  
III Comprehensive Distribution Cost Analysis

IV Abbreviated Methods of Distribution Cost Analysis

V Distribution Cost Standards

The first two sections are essentially a cursory review of basic accounting procedures, with the emphasis primarily on Cost Accounting. The authors have done an excellent job in condensing such a broad field of cost accounting into such a small space. It usually takes a year of care-

(Continued on page 323)

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## Book Reviews

(Continued from page 322)

ful study to master this phase of accounting. Many marketing people may find it a little difficult to comprehend this *accounting* phase of the subject unless they had a previous training in this accounting work. In Chapter 4, as an appendix of the chapter, the subject of *direct costing* is treated briefly. The discussion is well prepared, but the reviewer feels that because of the managerial implications of *direct costing*, this phase should have been expanded considerably and not treated as an appendix to a chapter.

Chapter 5 relates to Machine Methods as Applied to Distribution Cost Accounting. This chapter seems a disappointment to the reviewer. Today, when there is an increasing emphasis on the mechanization of office work and accounting, this chapter should have been much more instructive. The idea of the chapter was very good, but its coverage was meager. Maybe this chap-

ter would have been more valuable if placed later in the text—after the discussion of the methods of collecting distribution cost data.

Part III of this book is essentially the statistical and accounting analysis of distribution costs from the *viewpoint of the marketing department*. It is an excellent presentation in its thoroughness and detail, as well as in its practical nature. This section covers such topics as Marketing Functions and Their Bearing on Costs; Functional Expense Records; Marketing Expenses in Relation to Product and Customers; Profit and Loss by Product and by Customer; Profit and Loss by Unit of Sale; and Using Cost Analysis. This section devotes one chapter to a comprehensive cost analysis procedure for a manufacturing concern. This is an excellent method of summarizing and reviewing the principles of distribution costs previously presented.

(Continued on page 365)

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# THE NEW YORK CERTIFIED PUBLIC ACCOUNTANT

EMANUEL SAXE, *Managing Editor*

*The matters contained in this publication, unless otherwise stated, are the statements and opinions of the authors of the articles, and are not promulgations by the Society.*

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## The President's Page

Looking Ahead 1955-56

THE New York State Society of Certified Public Accountants approaches its 59th year. Those responsible for its administration can appropriately pause for a minute to look with some awe at its title. First, *New York State*. Certainly no reader will question that State's pre-eminence or the weight of its impact on national as well as local affairs. Then *Certified Public Accountants*. The "growth" profession of our time turned to alike by individual, corporation and government for advice and service in an ever growing field of competence. Finally, *Society*—, a banding together of the group for the better implementation of their high purposes in their own, and even more importantly, in the public's service.

It is little cause for wonder then that our list of past officers is a roster of professional leadership. It can be doubted, however, whether anyone listed on the roll of honor has ever thrown himself into the affairs of the Society with such enthusiasm, vigor and self-sacrifice, as has Jack Seidman, our retiring President. It is to our further advantage that these attributes have been matched by unusual ability and alertness, a high degree of imagination and a courageous willingness to, to use his own expression, "give a whirl" to the products of his fertile brain. His own factual reports will tell the story and I urge the membership to read them carefully. I deal with them here rather in terms of the future. Those now picking up the reins will be seriously negligent in

their responsibilities if they fail to follow through on the good works they have inherited from him and his predecessors.

The past administration has provided a rich feast for the Society. We are strong and youthful. We emerge with flushed cheeks but immeasurably enriched. Nonetheless, even youth is subject to indigestion and I think that it is perhaps providential that there is now wished upon you a President of less dynamic character who regards the period of digestion as complementary to the day of feasting.

Four areas of immediate concentration come readily to mind. I hope to cover them at greater length in later letters.

### Membership

With a membership of close to 7,500 we must still be concerned that there are 6,500 CPA's of New York State who are not members. Here the groundwork has been well laid. A revised dues structure has been established and designed specifically to attract to the Society many of those not now members. It is our responsibility to see that the opportunity bequeathed to us is used to full advantage.

### Chapters

Years of farsighted work have brought the Chapters to the point where they are no longer the children of the Society. They are one of the

most important and adult factors in its structure today. We lean on them increasingly for guidance and cooperation. Their very importance, however, creates a problem. It exceeds their relative numerical strength. Adjusting factors have to be provided in terms of both equitable representation and budgetary consideration. Here again the wisdom of the past should be brought to fruition. As we get to know each other better we should find it simpler to make these adjustments in terms of the currency of our profession - facts, - reason, - common sense.

#### Public Relations

Our very success as a profession and the rapidity of our growth makes us a natural target for the attacks of those less fortunate. When those attacks take legislative form our only real defense lies in a wide public understanding of our work and the sense of responsibility with which we approach it. In this regard we are less favored than many professions. Obviously, for instance, a far greater percentage of the population visits the doctor than the CPA. We can offset this deficiency in part through the employment of accepted public relations techniques. The American Institute of Accountants is providing a vigorous and greatly increased program in this regard and we must be prepared to support that program with our time, our imagination and possibly our

funds. We must also be prepared to tackle the problem the other principal way, by expanding our participation in civic affairs so that our contribution becomes better known throughout our communities and more acceptable "news" to the various media of public communication.

#### Cooperation with American Institute of Accountants

It is somewhat alarming for me to find that in percentage of Institute membership our State trails practically all others by a very substantial margin. Against an overall figure of 47 percent membership we have but 26 percent, with some states running into the 70's and one at over 90. This would disturb me less if my experience led me to believe that there were conflict or overlapping between the National and the State CPA bodies. The contrary is true. The recent difficulties with lawyers over tax practice evidence the need for well coordinated national and state action by our profession. Our collective strength is implemented through our professional organizations and I shall regard it as part of my obligation to encourage the participation of all CPAs of our State in both their national and state groups.

\* \* \*

These are mid-May ideas. It looks as though the period of digestion will not be one of somnolence.

HAROLD R. CAFFYN,  
President



# Interim Audits vs. Monthly Audits

By HERBERT B. FISCHGRUND, C.P.A.

*Interim audits and a new concept of monthly audits are suggested herein in lieu of conventional monthly audits. Practical suggestions are offered for the effective use of interim audit procedures to reduce year-end closing time.*

**T**ODAY, the accountant whose practice includes a large number of monthly audits finds himself in an increasingly difficult position. His clients, disturbed by increased costs, lower volume and reduced profits, turn to the accountant for help. The monthly audit fee, which didn't seem so high in relation to the greater profits of prior years, now seems substantial. This audit cost, reasons the client, has no direct bearing on increasing his volume; since fixed expenses must be shaved, he turns to his financial adviser for relief in this connection.

The accountant, meanwhile, is beset with his own problems concerning the monthly audit fee. He has found that his own staff and office costs have increased, and he is faced with ever-increasing demands on his time by his clients who now lean even more heavily on him for advice. These factors have made it increasingly difficult for him to maintain his own margin of profit. He is caught in a squeeze—what is the solution?

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Mr. Fischgrund is presently a member of the Committee on Interim Audits and has previously served on several other technical committees.

This paper was presented by him at a technical meeting of the Society, conducted at the Engineering Societies Building on November 18, 1954, under the auspices of the Committee on Interim Audits.

Obviously, since manpower cost is the major element of the accountant's expenses, we must cut the audit time to be able to effect any fee reduction for the client. Why not, therefore, substitute an interim audit for the monthly audit and eliminate the time-consuming monthly statement preparation. Let us examine the various aspects of this suggestion.

## Interim Audits

What do we mean by interim audit? An interim audit is an audit at any period during the fiscal year other than at the fiscal year-end. This definition would of course classify the monthly audit as an interim audit. My proposal suggests that the monthly interim audit be replaced by audits at either regular or irregular periods, as the individual circumstances require. The interim audit could be bi-monthly, quarterly or semi-annual; or it could be at irregular periods as mutually agreed upon between the accountant and the client. The audit dates need not be definitely set in advance. It might be advantageous or desirable, during certain business periods, to have more frequent audits. For example, audits during the summer months might be omitted in certain instances and frequent audits made during the heavy selling season.

## Reports on Interim Audits

An interim report prepared for a period longer than one month can often be more meaningful to management. Comparisons of one month's operations during the current year with the corresponding period of the prior year may often be misleading. For example, business that is seasonal, such

### *Interim Audits vs. Monthly Audits*

as Easter business, may fall in one month in one year and be spread out over two months in another year. The effects of weather conditions, industry tie-ups due to strikes, or other factors affecting sales or expenses, are less apparent when spread over periods of longer than one month. Adjustments and accruals can be made more accurately on a quarterly basis than on a monthly basis and variations are thereby minimized. A monthly statement ordinarily must be based on an estimated or "break-even" inventory. During certain periods of the year when sales are at a minimum or inventories are being built up, expense figures are distorted and these monthly statements are of little value. Perhaps at the quarter or mid-year, a physical inventory could be taken to provide more accurate and more helpful operating figures.

Too frequently have we seen our carefully - prepared, beautifully - typed monthly statement thrown in a drawer by the client after a hurried scanning. Surely this client can be educated to accept some substitute in lieu of a formal monthly statement. In some cases where a competent bookkeeper is employed, essential monthly reports and statistical data may often be prepared by the bookkeeper. Perhaps pegboard and strip-reporting devices can be installed and comparative figures prepared by the office staff. In other cases, where a qualified bookkeeper is not available, the accountant can review the monthly trial balance with management, after giving effect to important adjustments, in lieu of submitting a formal report. The accountant with a little ingenuity can devise a monthly report which would show certain key figures, such as month-end balances of cash, accounts receivable and accounts payable, sales comparisons, etc. Perhaps the bookkeeping personnel could be trained to prepare such a report for management.

Most credit grantors would rather receive an interim report based on a

physical or reliable book inventory than the usual monthly statement based on a "break-even" or estimated inventory. During the intervening months between statements, for those desirous of more frequent information, a detailed trial balance could be submitted to supplement the interim report.

### **Advantages to the Accountant**

The advantages to the accountant of the elimination of the monthly audit are many and varied. It permits scheduling of staff men to meet staff requirements. Assignments can be planned to effect the greatest efficiency in the utilization of men. Costly review and typing time are saved and the ever-increasing statement and office supply cost is reduced. The average staff man welcomes the change from the stagnation of repetitious monthly detail. The senior, supervisor or partner finds he has more time for management counseling and suggestions on the operation of the business, instead of devoting his time to routine adjusting journal entries and time-consuming monthly statements.

Some clients may be reluctant to accept the accountant's appearance at his office periodically rather than monthly. Perhaps they have come to lean heavily upon him for advice and guidance, or perhaps they feel that the psychological effect of a monthly appearance on the office personnel is important. In these cases I suggest an alternative procedure. The monthly time previously spent on the job can be continued and the routine monthly audit work and the monthly report eliminated. In other words, the accountant would continue his monthly visits, but would change the scope of his work. I will discuss these substitute reports and procedures below.

### **Advantages to the Client**

This suggestion may not fully solve the problem of reducing costs to the accountant and fees for the client,

since the accountant's time remains the same. However, it offers many advantages to both accountant and client and may justify in the client's mind the continuance of the usual monthly fee. The accountant, free from the time-consuming monthly report, can devote his time to other meaningful reports helpful to management. I refer to such reports as the following: Analysis of gross profit by product or division; inventory ageing; inventory turnover; determination of "break-even" points; departmental income and expense comparisons; budgets; statement of application of funds; etc.

Other specialized reports relating to the client's particular type of business could be developed to aid management.

Time can also be devoted to reviewing the internal control system. Too frequently, after an initial survey of the system, we are inclined to overlook possibilities of change required by normal business growth. Perhaps we can make suggestions on specific phases of the system to increase office efficiency and record maintenance. Perhaps a review of procurement planning and production control is warranted. The designing of simple forms for these functions may streamline and control operations. This excursion into the systems field may stimulate additional benefits for the client and bring with it additional income for the accountant.

The elimination of the repetitious monthly detail opens other avenues to the staff man for the use of his time. He may review the accounts receivable in detail. He can check credit and correspondence files and discuss slow or past-due accounts with management. He might confirm bad debt write-offs by direct correspondence. In these off-months specialized and varied audit procedures could be developed to fit the particular business or internal control system. Such varied procedures will act as a greater safeguard against those bookkeepers who are familiar

with the usual monthly stereotyped audit checks.

#### **Saving of Year-End Audit Time**

An important factor in reducing the accountant's personnel costs is the effective use of interim audit procedures to reduce year-end closing time. Since the scope of this paper encompasses cutting the accountant's costs through the medium of the interim audit, this latter portion is devoted to practical suggestions for accomplishing a reduction of year-end work. Many of these suggestions you doubtless know of and currently practice; all, I feel, bear repeating.

During the interim audits, running schedules of asset and liability accounts and analyses can be started and maintained. Examples of these are schedules of fixed assets and the corresponding depreciation allowance accounts, current additions to fixed assets, insurance, schedules of intangible assets such as patents, goodwill, etc. Analyses of the accounts for drawing accounts, contributions, and taxes can be brought up to date, as well as other profit-and-loss accounts. Certain key profit-and-loss accounts can be reviewed prior to the year-end for variations as well as errors of classification and distribution. Frequently, too little attention is paid to profit-and-loss accounts at the year-end in the normal audit.

Under certain circumstances a physical inventory taken at a period other than at the year-end is permitted, provided perpetual inventory records are maintained or other records are available to build-up and reflect inventories at the year-end. A physical inventory at an off-period may be desirable for both management and accountant. The company may avoid a complete shutdown of the plant with the resultant loss in production. The accountant can avoid the peak period assignment of staff men for attendance at the physical inventory-taking and spread out his

### *Interim Audits vs. Monthly Audits*

staff assignments. It should be emphasized that physical inventory taken at other than the fiscal year-end is not recommended for those companies which do not maintain adequate perpetual inventory records.

In any event, the interim periods may be used profitably to cut year-end inventory price-testing. Where a cost system is maintained, the cost cards may be checked out. Invoices may be inspected to check prices of frequently used materials and supplies. Schedules building up costs of manufactured or assembled items may be prepared in advance.

Reading and abstracting agreements, minutes and other data can be very time-consuming at the year-end. There may also be a tendency to short-cut this type of work under the pressure of the closing. Most of this, however, can be done during the interim audit. Minutes may be abstracted, and contracts with salesmen, customers or suppliers may be examined. Other data that might require examination or inspection are pension plan agreements, real estate deeds, leases and loan agreements. The stock certificate books and transfer records may be inspected during the year and quickly reviewed at the year-end for changes, if any. The "fine-print" of insurance policies be-

comes more palatable in a relaxed interim audit than at a year-end closing.

Audit procedures concerning cash can be more effective as well as more economical of time, if performed during the interim audit. Surprise cash counts may disclose irregularities. The requisitioning from the bank and checking out of duplicate deposit slips may uncover "kiting". Presence at the physical distribution of a plant payroll might be desirable where circumstances warrant.

Since the disclaimer required by Statement # 23 was put into effect, more credit grantors have demanded "certified" audits. The effective use of time during interim audits may make it possible for the accountant to accomplish many of the additional audit procedures required in a "certified" audit at a nominal increase in fee.

### **Conclusion**

In closing I believe that by the intelligent use of the accountants' time, the client, instead of getting less service under the procedures suggested, will now receive services of a more professional nature. Recognition by the client of these additional benefits and personalized service should lead to continuance of the old audit fee arrangement or, perhaps, to increased fees.



# Problems of Interim Audits from the Accountant's Viewpoint

By LEON MAZURSKY, C.P.A.

*This article reviews several problems encountered by the accountant in preparing for and carrying out interim audit engagements.*

**A**MONG the primary concerns of the accountant today are increasing auditing costs and the need for extension of his service to the client. Whereas accounting fees have about reached the peak, costs are still on the upswing. At the same time, since business is facing a most critical period due to competition, increased costs and lower profits, the accountant must give the client more timely and efficient services. How can the accountant reduce costs and at the same time render more efficient services to the client?

In my discussion tonight, I shall indicate several time-saving devices which the accountant may employ to reduce costs. I shall also show how cycle tests and proper staff assignments may improve the accountant's services to the client. I should also like to touch upon certain special problems concerning physical inventories and clients' demands for "certified" reports.

These problems are not peculiar to interim audits, but because of the nature of this type of audit engagement, they arise therein more frequently.

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He is associated with the firm of Seidman and Seidman, CPAs.

This paper was presented by him at a technical meeting of the Society conducted at the Engineering Societies Building on November 18, 1954, under the auspices of the Committee on Interim Audits.

## Time-Saving Devices

Interim audits require a careful analysis of methods to be used in order to conserve time on the audit while at the same time providing the service the client desires. Time costs money and the accountant's earnings can easily be consumed in the numerous recurring details that arise during every interim audit.

The auditor may save valuable time by preparing dummies of the trial balance, recurring journal entries, and reports. These should be prepared in multiple copies, for use on subsequent audits. There are any number of duplicating devices such as the typewriter, mimeograph, Ditto or Bruning machines, which can be used for this purpose. In preparing journal entries for interim reports, a good deal of time and detail may be eliminated by using rounded figures to provide for such adjustment items as depreciation, taxes, payroll, etc. To even greater advantage, the bookkeeper should be trained to record the adjusting journal entries on the books. The accountant should install annual depreciation schedules, insurance registers, interest registers, and so on, at the beginning of the year and determine the monthly or quarterly write-off or adjustment, so that the bookkeeper has the necessary figures for the journal entries.

Whenever possible, the accountant should enlist the aid of the bookkeeper in the preparation of certain parts of the report. For example, where the report requires a monthly schedule of sales, sales returns, commissions, purchases, purchase returns, and so on, these may very easily be prepared by

the bookkeeper who should have them available for the auditor when he arrives. The bookkeeper should be instructed to analyze such accounts as repairs, fixed asset additions, travel and entertaining, etc., and to hold the supporting vouchers in a separate file for the accountant. Unentered invoices should be segregated in a folder and a schedule prepared. The auditor would then only have to check the invoices to the list. The bookkeeper should have copies of the bank reconciliation available for insertion in the accountant's workpapers.

It may be possible that all of these suggestions can not be instituted. Nevertheless, the use of any of these time-saving devices will save the accountant time in writing up his workpapers and in the preparation of his report.

#### Cycle Tests

The desire for economy in the performance of the audit should not be such as to impair the value of the accountant's service to the client. We can improve this service without necessarily increasing costs through the use of cycle tests.

The client would be benefited if the accountant performed different phases of the audit on the various interim examinations. For example, in planning the scope of each interim audit for a whole year, the accountant would plan to audit purchases and inventory records on the first interim visit, sales and accounts receivable on the next interim audit, and so on. Cycle tests would enable the auditor to make systems studies a regular part of every examination, instead of a time-consuming task after the usual audit is done. It is conceivable that areas might be reviewed that had never been examined before. The accountant could confirm accounts receivable balances during the year on a test basis, instead of just checking the accuracy of the bookkeeper's accounts receivable

schedule. Confirming receivables during the year has special importance in that the element of surprise is added. In the Codification of Statements on Auditing Procedure, particular mention is made of this suggestion. It reads as follows:

"Frequently the conditions surrounding a particular engagement may be such as to warrant or even make desirable, the staggering of the confirmation process throughout the semi-annual or annual period. If this is done in an acceptable manner and the results are satisfactory, necessity for exception as to the scope of the interim examination respecting confirmation of receivables is removed."

Execution of the procedures at a date or dates other than that of the balance sheet will have the incidental but valuable advantage of reducing year-end pressure."

For that matter, since accounts payable confirmations are not a required year-end audit procedure, these balances could be confirmed on a test basis at various times during the year. If found to be accurate, confirmations could be eliminated at the year-end.

Where perpetual inventory records are maintained, these could be audited during the year on a cycle-test basis. The burden of checking these inventory records may thus be removed from the year-end when the pressure of work is the greatest. Cycle tests, therefore, present a method by which the accountant may improve his services to the client by:

1. Allowing an opportunity for system studies throughout the year;
2. Distributing the work load throughout the year;
3. Introducing an element of surprise, as in the verification of accounts receivable and payable during the year.

#### Staff Assignments

Another method of improving services to the client is through an efficient system of staff assignments. The pro-

cedure followed by accounting firms in making staff assignments usually fall into three categories: (1) fixed assignments; (2) complete rotation of personnel; and (3) limited rotation of personnel.

### Fixed Assignments

Because of the frequency of interim audits, most staff assignments fall into the pattern of *fixed assignments*. The same clients are audited throughout the year, until we almost welcome the change the tax season affords. This quickly cures us, of course. However, there are certain advantages to a fixed assignment. Administrative work is held down to a minimum. The senior contacts the client directly, prepares his own work schedule, and is able to give the client regular service each month. Because of his familiarity with the affairs of the client and trends within the client's industry, time spent on the audit should be reduced. The client's staff becomes familiar with the auditor's requirements and is prepared to fulfill them. This also aids in reducing time on the audit.

But what are its disadvantages? Suppose the auditor is required on another engagement, or is ill or on vacation, or leaves for another job? Service to the client may then be delayed. This possibly could be serious if a statement is needed quickly. A staff member with several days of unassigned time each month may possibly stretch his regular assignments rather than indicate his availability. Then, too, familiarity with the client's staff may be a disadvantage. The auditor's work may become careless, and a general laxity in the performance of the audit may result. This may lead to serious consequences. Carelessness should be a flag to the review department of any organization. Another disadvantage of fixed assignments is that the firm loses its identity, since the client's relationship is confined solely to the auditor on the job.

### Complete Rotation

As a means of overcoming the disadvantages of fixed assignments, some accounting firms have adopted the plan of *complete rotation* of personnel. What are the advantages? Upon completion of an audit, all available staff members form a pool. Therefore, as soon as a client is ready for audit, the first available man is assigned, within limitations of course. A number of advantages, other than faster service to the client, stem from this procedure. Staff members obtain a much broader scope of experience. Men are always available for special assignments that may arise. Accounting firms are compelled to use standardized work papers. An auditor would not become lax on his job when he knows that another auditor may follow him on the next audit. There would be no danger of an auditor becoming too familiar with the client or his staff.

However, a number of disadvantages arise that cannot be ignored. There is a great deal of time lost on every audit to allow for review and familiarization. A client might object when he finds a new auditor poring over his books on practically every interim examination. Certainly, more administrative work is required in making assignments and a larger review department might also be necessary. Extra care in the review of workpapers is required when almost every engagement is performed by a new man. The newness of the auditor's assignment may also result in his overlooking salient parts of the audit. It would, therefore, seem that the adoption of this method requires careful consideration.

### Limited Rotation

Firms seeking to combine the advantages of the two plans while minimizing its disadvantages use the plan of *limited rotation* of personnel. The procedure is to have a senior and an alternate senior for every client. The success of this plan requires that the

senior accountant not be paired with the same alternate for any other engagement. A further improvement is the complete change of assignments among staff members after a number of years. This method of assigning personnel would result in faster service to the client with little loss of time for review of papers and for familiarization; faster audit time without the danger of familiarity with the client and the client's staff; a broad scope of experience for staff members seasoned with enough repetition to allow the staff member to feel that he has some regular assignments. The client's objections to new auditors every month would then be eliminated. The accounting firm may in this way improve service to the client while creating a more efficient method of assigning its staff members.

### **Inventory**

Now I would like to discuss several special problems which may arise during interim audits. The first relates to inventories.

We are usually called on to give the client a "break-even" inventory figure or to use inventory figures that the client's staff has prepared. The use of inventory figures submitted by management will not relieve the accountant of all interest in the item. The accountant has the tools with which to test the reasonable credibility of the inventory submitted. Testing the accuracy of the inventories is important in all cases where the inventory is a substantial part of the balance sheet. A client may be operating at a loss, but may be lead to believe that he is operating profitably because of inaccurate inventories. At the very minimum, we should use the gross profit percentages as a gross check. The gross profit relationship may be obtained from prior years' experience or by testing the cost elements of specific items sold. In using prior years' gross profit percentages the accountant

should also keep uppermost in his mind the fact that such percentages must be adjusted for current conditions. If there is an important variance in the gross profit percentages, we should scan the extensions, footings, and the pricing of some of the larger items in the inventory. It might also be possible to find errors in quantities by test-count of larger dollar items in the inventory at the time of the audit and then reconciling back to the inventory date. The testing of inventories is a service the client needs and ought to receive from his accountant.

### **Statement # 23**

The other problem relates to our clients' demands for an expression of opinion in connection with reports rendered to them. By now, we are thoroughly familiar with provisions of the Auditing Procedure Statement No. 23. Since the scope of the interim audit is not ordinarily sufficient to warrant the expression of an opinion, Statement # 23 is, therefore, particularly applicable. We are still being faced with the problem of clients who insist on an opinion report when nothing but a complete disclaimer can be given. Nothing more can be said but that we must continue to educate our clients as to the standards of practice of our profession. We are receiving more and more cooperation from credit grantors who know that, except for unusual situations, the interim audit is not one which will result in an expression of an opinion. For this reason, the accountant's unqualified opinion on a report has greater value. We must strive to keep it that way.

The October, 1954, issue of *The New York Certified Public Accountant* published the results of a survey of audit reports submitted to banks, which was conducted by the American Institute of Accountants. The submission of audit reports by independent public accountants in connection with applications for bank

(Continued on page 342)

# Partial Budgetary Control Applications in Small Business

By NORMAN J. ELLIOTT, C.P.A.

*This paper discusses practical control applications of the budgeting principle to small business, with suggestions as to types of limited or partial budgets. The message of the discussion is directed to education and development of clients in budgetary controls through the relatively inexpensive partial or limited approach.*

**I**N the course of any discussion about budgeting, many small business men and, too often, their accountants, take a hopeless or defensive attitude. They agree that budgeting is a sound concept and then proceed to deny that they can afford or use such management frills.

## Need for Education of Clients as to Value of Budgetary Controls

It follows that if owners and managers of small business really believed in their need for budgetary control, they would do something about it. Thus, small business needs education in the meaning and possible scope of

inexpensive budgetary controls before its lip service to the concept will mature to practical application. Not much less behindhand are the majority of accounting practitioners who have not only failed to educate their clients in this regard, but have also subscribed substantially to the philosophy of their clients. In partial justification, let us realize that this has resulted from a lack of training in the subject in the schools and in the course of the field apprenticeship of accountants, as well as the constant pressures of work in the field and the need to maintain current knowledge in taxation, finance, economics and accounting developments.

Make no mistake about it, however, this has created a vacuum into which management consulting firms are moving constantly. They are not only competing with, but successfully overshadowing the accounting profession in management services for which the accountants should be well qualified. Most of these services relate to budgeting, costs, and their control applications.

It therefore behooves the accounting practitioner serving smaller business, not only for the good of his clientele, but also for himself, to develop a greater awareness of sound short-cut techniques to cost and budgetary control. He should also attempt to educate his clients to the need for the application of these methods to business management.

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Mr. Elliott is a partner in the firm of Levess and Elliott, CPAs, and is a consultant to the National Paper Box Manufacturers Association. He has been active in management consulting activities for many years.

This paper was presented by him at a technical meeting of the Society sponsored by the Committee on Budgets and Budgetary Controls, of which he is a member, held on March 30, 1955, at the Engineering Societies Building in New York City.

### Types of Budgeting Techniques

In the field of budgeting, with which we are here concerned, we must consider the possibilities before discussing the limited applications. For example, cash budgeting is not the same as operational budgeting. It requires a different technique, but yet is dependent upon operational data. At the same time, operational budgeting purely in terms of money is a far less useful tool than operational budgeting in terms of activity, such as labor-hours, machine-hours, quantity levels of production, and the like. Further, with respect to these several types of budgeting, consideration must be given to the choice between fixed budgeting and flexible budgeting. Most accountants think of budgeting in terms of a single or expected level of business and suffer cruelly when, after careful development along such lines, the actual level of business in the budgeted company is so different that budget comparisons become onerous and not as useful as hoped. This is the curse of fixed budgeting. Flexible budgeting, on the other hand, requires a study of the disproportionate changes in elements of operating or manufacturing cost as levels of manufacturing or operating activity change. On the basis of that kind of investigation, a series of parallel fixed budgets may be prepared, each for a specific level of activity. The aggregate of these parallel budgets is called a flexible budget.

### Partial Budgetary Controls

With respect to small business, the effort required to develop all of the foregoing budget applications in their entirety might well exceed the expense and time tolerance of management. Consequently, partial budgeting techniques may be advisable in order to establish key controls and also to initiate progressive development of management controls. Some examples of partial budgetary controls are:

1. Specific budgets of "controllable expenses", only.

2. Tables of personnel requirements at varying activity levels (Manning Tables).
3. Overhead budgets for specific departments, compared with activity factors to develop:
  - a—Standard overhead cost per direct labor-hour;
  - b—Standard overhead cost per operating machine-hour;
  - c—Standard overhead cost per unit of production (pounds, gallons, dozens, etc.).
4. Effective activity (man-hours; machine-hours) tabulations at different business volume levels vs. total available hours.
5. Delivery or trucking activity in terms of
  - loads daily/weekly/cumulative
  - stops daily/weekly/cumulative
  - mileage daily/weekly/cumulativefor drivers and for trucks.
6. Estimates of elements of product costs in terms of materials, productive labor, and overhead at varying levels or a single level, compared with the reasonable, or planned expectancy of production, so as to develop budgeted standards of cost for the separate elements.

The value of the foregoing examples of partial budgetary controls is not only in the investigation and determination of operating activity in relation to resulting costs or expenses, but also in the comparison of estimated or planned results with actual performance. By way of specific example, consider the case of a shoe manufacturer who claims he knows his unit cost per pair of shoes, as to materials, productive labor and overhead. If his shop's production were multiplied by predetermined (budgeted) unit costs, and the results tabulated in terms of standard material, labor, and overhead cost totals, the basis for comparison with general accounting results has been

developed. This kind of comparison would expose areas and the extent of differences between plan and performance, so as to compel intelligent investigation of error in planning or discrepancy in performance.

### **The Manning Table**

Another example of partial budgeting is the Manning Table. A cursory examination of most income statements indicates that aside from product materials, by far the largest cost and overhead factor is the payroll. In addition, the number and kind of people (as to skills, job activities, etc.) employed directly, affects most other variable costs of production or doing business. Consequently, an adequate budgetary control of personnel requirements and activity must of necessity establish substantial control of operating cost variables. An objective inquiry into workloads, minimum manning needs, and work activities should provide the basis for a sound manpower budget in terms of people and periods of work. Relating this information to established or predictable rates of pay, and classifying the information according to expense and job nomenclature should result in a budget of payroll. If this were done for varying levels of business activity, the result would be a flexible budget of payroll costs with which management could make detailed comparisons of actual payrolls for control purposes. This is the kind of directly-to-the-point measuring template that non-technical managers prefer.

### **Production Overhead Load Control**

Still another example of partial budgeting control may best be described as a production overhead load control. This may be set up by preparing a production expense or overhead budget for a department or a plant, while at the same time developing a planned or estimated comparable measure of production activity in terms of ma-

chine-hours or productive labor-hours. Dividing the activity units (hours) into the budget total calculates a resultant overhead load standard of so many dollars and cents of overhead per running machine-hour or per productive direct labor-hour. If, thereafter, overhead expense experience should run higher than the amounts budgeted without any commensurate increase in productive activity, the index will rise. If, on the other hand, productive activity should rise proportionately with or more than overhead increases, or if activity remains in planned proportion or better with respect to the total of overhead expenses incurred, the index will match or drop below the load standard previously determined. The foregoing procedure requires, you will note, a study and budgeting of both expense experience and related producing activity. The combining of the two elements in a readily understood index of cost load merely provides a common denominator of results to be used as a control indicator much in the same manner as a gauge on a piece of equipment. The utility in this procedure is in the uncomplicated recognition of a production cost fact from two variables which may never quite match the most precise budget plan. However, unless the load cost indicator becomes a stimulus for management to investigate the reasons for variations and the details wherein budget and actual results may differ, that utility would be wasted.

### **Cash Budgeting**

Mention has been made previously in this discussion of cash budgeting as being an element of the entire budgetary process. Many small businessmen, finding so-called cash projections or forecasts difficult to assemble, have discarded consideration of them as so much educated frippery demanded by banks and credit sources only "to show in the file." Consequently, when necessary for purposes of developing a line

of credit, such a businessman authorizes the "perpetration" of an estimate of a summary forecast of cash flow, without the necessary groundwork of an operating budget upon which such a cash budget must be based. Members of the accounting profession often come nobly to the rescue with hurriedly-developed tabulations, giving only modest recognition to the need for real study of the production cycle or the money-time-cycle of business operations. This is a mistake.

Not only are operating budget elements important for determining the probable requirements for payrolls and commitments for purchases of materials and supplies on credit, but also for establishing some basis for an inventory policy. If it were possible for all sellers of goods and services to conjure up salable goods and usable service supplies at the right spot for use or delivery the same day as performance of the sale or service, there would theoretically be no need for inventories. However, in certain industries, there might still be the desire to maintain inventories at some times in order to gamble on a rising market. Unfortunately, it takes time to purchase and receive or to produce goods and supplies needed to complete performance on orders. In the case of a manufacturing business, it also takes time to process and complete the manufacturing and packaging of products. In the case of trading businesses, it is necessary to allow time for checking, handling, pricing, tagging and otherwise making the product ready to move out, not to mention the time lag required to develop the sales-turnover program. All of the foregoing involve elements in the money-time-cycle of a business.

The determination of inventory policy must necessarily rest on such factors as the money-time-cycle. Normal sales during replacement time establish a minimum basic stock quantity to permit the steady filling of customers' orders during the period under

consideration, given adequate determination of replacement time or the production cycle. Price allowances and terms based upon quantity purchases may dictate the minimum size of goods replacement orders to such extent as to affect the amount of inventory necessarily to be carried after purchase. The availability of money resources and credit must necessarily affect the company policy as to the size and frequency of purchases to be made. The reconciliation of all these considerations, some of them conflicting, will create some kind of an inventory policy subject to the vicissitudes of business success in getting goods sold.

Coming back, then, to the cash budget, we see that the replacement or production cycle for merchandise together with the inventory policy of a company must be determined and included in any estimate of transactions affecting a cash projection or budget. These factors, difficult as they may be in themselves, must further be determined in different aspects to meet the requirements of seasonal operation. Add to that the company's policy on credit extension, terms and its effective collection turnover, and you have still a more complete picture of the elements needed in considering the problem of constructing a cash budget. To all of the foregoing must be added some knowledge or recognition of available money financing to which the company may resort in order to assist in leveling out the variations in cash demand and availability.

Aside from an understanding of the problem of constructing a cash budget, there must be an appreciation of collateral considerations and possible benefits. If you have a client whose total money-time-cycle from raw materials to collected proceeds of sale is something in the vicinity of four months, and if in the course of a budgetary study in preparation for constructing a cash forecast you develop knowledge of reasons for this extended

time cycle and possibilities for reducing it by changed business methods to something like seventy-five days, you may be in a position to develop savings in cost of doing business and to increase the potential volume of sales that could be handled. By reducing inventory requirements or the need for the use of costly money, or in increasing the volume effectiveness of a given capital structure, this kind of budgetary study may pay real dividends in reduced costs or increased profits.

### Distribution Costs

Another example of the potential direction of a partial budget effort is the operation of vehicles, one of the substantial elements in today's distribution costs. Without laboring the point too much, one of the service industries which has for a long time suffered from high-cost operation is the distribution of home heating oils. These distributors are usually involved with the delivery of fuel in small fleets of tank trucks under varying weather, location and storage conditions. They usually also maintain service departments to keep the oil burners of their customers operating under emergency conditions when failures occur. Sometimes they charge for this service and to some extent they consider the operation of the service department as a cost of doing business. Imagine, if you will, the success which might be met in attempting to control or minimize these costs merely by setting down together in neat rows the elements of expense that go into the total. If a business operates twenty trucks when with efficient planning and traffic management twelve could do the job, no process of figure arranging and paring is going to bring down the unit cost of deliveries. Consequently, the budget study in the trucking problems of a fuel oil distributor must necessarily be directed to the number of loads handled per period per truck and by each such truck; the relative cost of delivering in

large tank trucks as opposed to the experience with respect to other sizes; the effective capacity application of loads by adequate combination routing so that all the oil carried in a given tank load is delivered in one trip, and so on.

With respect to service operations, the problem is much less obvious and could stand considerable thought along the lines of classifying customer installations with respect to age, service history, location and the like, in order to determine either a pattern from which to anticipate problems, or from which to determine a scale of charges required to compensate some reasonable proportion of segregable costs. In addition, it may be highly profitable to have servicemen file time reports as to jobs and activities in order to determine the nature of the application of their time.

Considerations such as these must be given weight along with the study and determinations of money amounts of expenses by classification and by period which may comprise the elements of an operating budget. It is therefore quite reasonable to suggest to small business that a partial budget study directed to a single department or activity at a time could be enlightening and profitable without being unduly burdensome and costly if such activities are aimed at problems, one at a time, in the order of their importance.

Similar tabulations and comparisons may be developed with respect to other types of partial budgets. It must be emphasized however, that before partial budgets can be refined and put to use as controls, all money estimates must be related to the activity factors on which they depend. These activity elements must be at least as carefully investigated and projected as the money budgets. Statistics in terms of unit activity or product costs developed in this manner become standard ratios or indicators of planned performance

to be compared with operations so as to measure the adequacies and the failures of performance for management.

### **The Role of the Professional Accountant in His Clients' Budgetary Activities**

While considering the role of the professional accountant in connection with the budget activities of clients, we must recognize that it would be very difficult as well as uneconomic for the outside auditor to perform all the budget functions under consideration, including the detailed assembly of data. The better view would be to give recognition to the fundamental principle of budgeting activity as it is applied successfully in so-called big business, that without participation and concurrence of the entire management team in the objectives and elements of a budget, its effectiveness as a tool of management must necessarily be poor. In developing recognition of budget principles and practice among clients, the professional accountant should strive to be a sort of part-time budget

director or coordinator over the detailed activities and contributions of their management and clerical staff. He should be prepared to point the way to adequate consideration of activity as well as historical money factors, to explain and mold the detailed techniques of assembling data, and act as an interpreter and evaluator of the resulting information. But in all events, for best results, the professional accountant must get the agreement of the people who are to live within the budget, as to its scope, composition and substantial details.

This concept of partial budgeting, in substance, represents the first phase of budget indoctrination and application for the business organization inadequately staffed or trained in this field. It also represents a type of service that the independent accounting practitioner can render to his clients within limits of time and fee possibilities. If he does not, some managements can and will resort to the services of management consulting firms, some of whom do excellent and reputable work in this field.



### **Problems of Interim Audits from the Accountant's Viewpoint**

(Continued from page 336)

loans has become increasingly common practice in recent years. Bankers and members of the accounting profession have both been concerned about the adequacy of such reports and the reliance which can be placed on them. The purpose of the survey was, in part, designed to determine accountant's practices in expressing or withholding an opinion on financial statements.

It revealed that in less than five years after the adoption of Statement # 23, four out of five of the public accountants whose work was examined have accepted and put into practice the standard of reporting that requires an auditor's report to contain

a clear-cut indication of the character of his examination and the degree of responsibility he is taking in his expression or disclaimer of opinion.

### **Conclusion**

In conclusion may I state that the foregoing are only a few of the more current problems with which the Certified Public Accountant is faced. I have endeavored to outline them and offer some solutions. Whatever solutions you may endeavor to employ, remember that the primary consideration should always be to render a professional, conscientious service to your client.

# Practical Cost Controls—How They Can Help Management Improve Profits

By MAX BLOCK, C.P.A.

*Though this paper was designed for presentation to the executive personnel and plant superintendents of the firms comprising the metal decorating industry, most of its thinking is equally well applicable to business in general. In it the author outlines many valuable suggestions for cost control and cost reduction that will be of interest to accountants who assist clients with management problems.*

## Introduction

I DEEM it a privilege to have been selected one of your convention speakers. The subject, Practical Cost Controls—How They Can Help Management Improve Profits, is one, I understand, that is of considerable immediate interest to the industry, particularly to the trade shops.

Literally hundreds of books and pamphlets have been written on the subjects of cost systems and controls, and the number of talks on this subject is beyond estimate. Nevertheless, with a humility derived from the recognition of what has gone before, I will endeavor to make some additional contribution to this infinitely fascinating and vital subject.

It may interest you to know what a group of English industrial experts, who recently made an intensive study

of the factors that account for the spectacular growth of American industry, observed about cost reduction. This is what their published report states:

"American management has, as the mainspring of all its actions, the well-founded belief that unit costs must be reduced each day and every day, week in and week out, year in and year out. This habit of thought is so natural to American management and accountants that it is taken for granted. They are aware that, if the unit costs in real terms are not continuously reduced, the standard of living will not rise and the raising of the standard of life is a religion to Americans."

I am mindful of the fact that this audience consists of top executives and plant superintendents, and not of company controllers and cost accountants. For that reason I am not going to confront you with technical talk about how to set up and operate a cost system. Instead I will deal with the subject of cost controls in a manner practical for a non-accounting audience.

It is also recognized that this is a diverse audience in the sense that here are assembled representatives of trade shops and private shops; large companies and small companies; organizations that have established cost systems and some that are just playing with the idea of cost systems. Very frankly, my discussion is intended essentially for the trade shop that is interested in cost controls but which

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has as yet made little progress in that respect. These trade shops, I have been given to understand, fall into the category of small business though all have substantial investments in plant and equipment. Nevertheless, the ensuing discussion should have some significance for all members of the industry.

I would like to point out, at the very outset, that it is possible to have cost controls without a full-fledged cost system. Every company that is without an integrated cost system nevertheless has some cost information. It is required for the most elementary form of business management. A simple record of the number of sheets printed daily by each machine is one form of cost control. The report on machine time lost, overtime, materials consumed, and many other simple, internal control data also constitute phases of the general subject of cost control. It is these internal reports, which represent the efficiency thermometers of business, that are the main theme of this discussion.

Cost controls are applicable to every department and function of a business. Though the manufacturing operation is the major consideration, you must also be concerned with the costs and efficiency of the receiving department, the warehouse, the shipping department, the sales and promotion activities, the office, and of every other department and function. Of what value is it to have an efficient production operation if the drains and losses elsewhere consume the contributions of that department to the company's earnings.

A wise executive takes the view that each department should contribute to the company's annual income, regardless of its function. This viewpoint may sound odd at first thought for how, for example, can the billing clerk, or the receiving clerk, or the shipping clerk, and their respective departments, be considered anything other than just

overhead or a dead loss to the company? The answer is simple—if a department operates efficiently, if its costs are in reasonable proportion to the over-all costs, if it is progressively developing cost reduction procedures, that department is contributing to the company's annual earnings. Otherwise, a department is a drain on the income contributions of the others.

Think of it this way—a company takes an order for 5 boxes of bottle caps for, say, a total price of \$100. How much of the cost of all of the functions involved, from getting and writing up the order to billing and collecting the sales, should properly be allocated to each operation? Would it make sense if the mere handling of the raw materials cost \$10, or that the billing clerk ran up \$2 of cost, or that \$5 of metal storage cost be incurred prior to running the job? Even without a cost system one could readily recognize that the exaggerated costs just referred to are way out of line in relation to the total selling price or to the total cost of the order, whichever basis one would prefer to work with. This illustration should demonstrate the need for cost and efficiency consciousness in every function and department of a business.

In a highly competitive economy such as we are in today, and which is a normal state except in abnormal periods, management has limited control over selling prices. Some trade shops in your industry—I don't know whether all are involved—publish their price lists. This information is available to their customers, and to their competitors. As a consequence quoted prices within competitive geographic areas tend to be quite similar. The high-cost producer and the low-cost producer are tied down by virtually the same scale of prices.

Equally fixed are the costs of the materials you buy, and the labor rates you pay. Quantity discounts are an insignificant factor in purchases and labor unions impose uniform wage

## Practical Cost Controls—How They Can Help Management Improve Profits

rates on a regional basis. In these respects no business manager is in a position, generally, to secure any particular advantage over a competitor. Some advantage can be derived from the use of larger and faster machines, and from the use of better continuous-flow production lines, but in this respect, too, I have been advised, there is not too much variation between trade shops within a competitive area.

Thus, business managers find themselves in the position where, between relatively fixed selling prices and fixed material prices and labor rates, the only avenues left for cost reduction are the most efficient utilization of materials, labor, and equipment, and the most effective control of non-production costs. This all adds up to the fact that only companies run by sound, hardworking and progressive management can withstand, and thrive in, a normal, competitive period.

It is not enough to know the costs of various operations. One must compare such costs to some standard, a carefully pre-determined ideal cost, to determine whether they are high or low. Moreover, a standard is not a static factor. Management must endeavor constantly to improve standards. In brief, good management means ceaseless endeavor to improve quality, service, processes, and to reduce costs. Complacency in these matters can only prove to be fatal, in time. The large investment in equipment warrants a return that will compensate for the capital employed, provide funds for the replacement of equipment, compensate management satisfactorily, and yield a fair profit.

A leaflet distributed by the Small Business Administration on the subject of "How to Reduce Your Operating Costs" contains some gems of business wisdom. One of them is appropriate at this point and it reads as follows:

"Actually, the most practical gauge of operating costs is: can you get them down any further. But operating costs are a symptom and not the underlying cause

of the current health of a business. To reduce them it is necessary to do something specific about the factors which control them. Furthermore, such action must be positive rather than defensive; it must be continuous rather than intermittent.

Any half-hearted attempt to reduce costs is likely to fail. For successful solution the problems can't be thought of as important today because there is time to think about them, and unimportant tomorrow because the pressure of other work has built up. Some managers, to be sure, never realize how unnecessarily high their operating costs are until after they have embarked upon a full-scale program of cost reduction. But once the program is underway the resulting savings, more often than not, will finance its continuation as a regular function of the business."

### Internal Reports—A Major Cost Control Tool

Reliable information, on a regular, time-table basis, is essential for management to keep informed as to the daily production activities—their volume and their efficiency. Personal observation, whether by an owner, a superintendent, or a foreman, is by itself inadequate for this purpose in a multi-function business such as metal decorating. Only written reports, a separate one for each major activity, can properly bring to management the data it must have, and in the efficient form in which it should be available. Supplemented by reasonable personal supervision these internal reports constitute management's major tools for control.

Internal reports should be prepared by the company's own personnel, wherever practical. Every machine operator, for example, should prepare a daily production report. A report on materials consumed and balance on hand might be prepared weekly or monthly by the stock clerk. The payroll clerk could submit for each payroll period a report on the number of employees in each department, turnover, overtime hours, and other desired payroll data.

Your bookkeeper, or controller, as the case may be, should supply certain information to you. Certified Public Accountants who audit a company's records at monthly intervals may also be called on to prepare certain statistical data for inclusion in their reports or separately. The accountants who are management-conscious review the operating and financial trends continuously and analyze and discuss them with management. In this respect they constitute an adjunct of management.

Internal reports should be printed forms and each report should be carefully designed to provide the required data in the most efficient and useful manner. Reports should, wherever possible, be uniform in size but variations as to the color of the paper can be helpful. Moreover, the reports should be punched so that they can be filed in a binder for future reference. Every report should be signed by the person preparing it and, where desirable, by an executive such as the plant superintendent, foreman, or other person.

The internal report must be considered a very important document. It must never be treated with indifference because, if employees sense this condition, their reports will tend to become less accurate and untimely, and their morale and cooperation will deteriorate. It is important that the reports be submitted promptly and every instance of lateness should warrant an explanation.

It is also important that the report be complete, with all mathematical computations fully made and checked, and all explanations fully but concisely made. This will be a great aid to the executive who is required to review the reports and will save his time in making calculations and in raising questions.

Finally, the reports should be discussed at regular intervals with department heads and employees, and on other occasions when there is cause.

These discussions will prove most valuable, if properly carried on, in cementing good relations, in sustaining the interest and cooperation of employees in their work, in getting employee suggestions, in keeping management intimately informed on matters that might otherwise escape notice, and in other practical and worthwhile respects. Employees will get into the spirit of constantly seeking for new heights of efficiency if they are made to feel that they are no mere automats and if they are encouraged to think, plan, and bring their ideas to management. Incentives and rewards, in conjunction with this sort of encouragement, have proven most valuable to the outstandingly successful companies in every industry.

The last point to be made about internal reports is that they actually free the owner from the need of keeping too close to the shop or to any other department. His internal reports, properly prepared, are better eyes and ears than his own. He can give more time to planning, to sales promotion and new products, and to the countless other top-level problems that compete for an executive's time. It is true that the mark of a good executive is his ability to effectively handle a business operation from a clean desk. Good internal reports can help make this possible.

They will also permit a business owner to train an understudy by having that person review all internal reports first and then discuss them with him. Even absence on vacation or on account of illness will have less terror for a principal if he knows that internal reports will be prepared in his absence and, if deemed necessary, sent to him wherever he may be.

It is felt that relatively few internal reports are now being received by the owners of trade shops, and that they are not being utilized to their fullest potential.

### Recommended Internal Reports and their Control Effects

The following internal reports are recommended to your industry, and their control effects are described. You may, of course, create any other reports suitable to your needs.

#### Daily Press Production Report

This is undoubtedly the most important report, excluding perhaps the period operating statement. Very likely it is one of the few internal reports that even the most poorly controlled organization now prepares. Nevertheless it is worth reviewing because it is felt that this report is not being utilized to its greatest potential.

The report should be prepared daily by the operator of each piece of major equipment. It should disclose for each order on the machine, as a minimum, the following data:

Order number
Number of sheets
Sheet size and gauge
Make-ready time
Running time
Average sheets per hour, running time and total time
Total base boxes
Sheets spoiled

In addition, the report should list each stoppage, other than for make-ready purposes, setting forth the elapsed time and the explanation. This will provide a complete accounting of the machine's full day's time. The total number of sheets run and the base boxes involved may not always have real significance if there are many short-run orders and there is much variance in the different sheet sizes and gauges. Nevertheless, the grand total of sheets and base boxes should be computed in order to determine the average production per running hour and machine hour for the day. Some lost time may properly be chargeable back to customers and suppliers and its control will start in the production report.

The heading of the daily report will contain space for the title of the machine, the name of the operator, the operation and color, and date. The quantity of materials consumed may be reported on the production report because there is a definite tie in with the total base boxes, or in a separate materials consumed report.

When the report is received in the office it should be reviewed and analyzed as follows:

1. The following operations should be checked as to conformity with standards and substantial variations inquired into:

- (a) make-ready time
- (b) sheets produced per running hour
- (c) quantity of materials consumed

2. The time lost other than for make-ready, for which there are about 30 common causes, should be analyzed and items that appear abnormal investigated. A brief comment should be made on the report re every significant time loss. Where a breakdown due to mechanical failure is involved and more than  $\frac{1}{4}$  hour is lost, a report on the breakdown, signed by the operator and the mechanic, should be submitted. An independent historical record for each major machine should be maintained of each mechanical breakdown of more than one hour and each major repair. Review of this record may help determine, at the earliest practical time, that the machine is too inefficient or worn out or, perhaps, that the operator is too careless.

3. The amount of materials spoiled should be recorded either on the machine report or in a separate spoilage report. Information should be furnished as to the quantity of the customer's sheets that were spoiled and the credit, if any, therefor. Also, how much coating or ink may have been spoiled due to improper handling, spillage, etc. The spoilage report should be signed by the pressman and subsequently should be reviewed and

signed by the foreman or superintendent. Abnormal spoilage and excessive use should be checked.

4. Electricity usage for the day should be recorded. There is a direct relationship between the kilowatts consumed and the press output. To accomplish this each major machine or group of machines should have its own meter to measure kilowatt usage. High power use and low production may be indicative of substantial spoilage or other bad condition.

Purchased fuel used to heat the oven should also be measured and recorded daily. This is not as easy to relate to output as press electricity because the oven heat is not turned on and off as readily as the press. Nevertheless, the fuel cost per hour, regardless of use, can be compared with a standard. Excessive use may disclose poor combustion, excessive heat loss, or other fault.

Incidentally, power and purchased heat rates should be checked by rate consultants. Occasionally it is found that a rate can be lowered by a reclassification.

5. The number of man-hours of the machine crew may also be recorded. On continuous runs lasting a day, the number of sheets produced should be analyzed in respect to the man-hours of labor. To check on the productivity of overtime work, the man-hours, and sheets produced in the overtime period should be separately recorded. Poor production in the overtime period warrants investigation. Where short runs are involved the man-hour data may have limited value but it nevertheless can be used to check production during overtime periods.

6. The direct-labor cost and machine-operation cost can be computed for each order for use in those cases where job cost calculations are desired. By compiling the total of the labor and machine costs, and of the cost of materials consumed, it is possible to compute the gross profit-margin on each order. The dollar margin

so determined can be translated into a percentage of the sales price and that percentage should then be compared with the standard. Provision for all of this data can be made on the machine report or a separate, supplementary report.

#### **Materials Used Report**

The sizings, coatings, and inks used on each job should be the subject of a report. This may appear on the daily machine report or it may be a separate report. The usage should be compared with a standard to determine the efficiency of the consumption. Spoilage may also be recorded on the materials report.

If a quality-control technician is employed, he logically should review these reports, make investigations where necessary, and write his comments on the reports before they are turned over to top management for final review.

An efficient method for handling materials involves the daily requisitioning of the materials required for each day's run of a press. Where a quality-control technician is employed, and he has pre-determined standards to determine the quantities required for each type of job, he is the one to determine the aggregate materials to be turned over to the press operator. As a practical matter, a larger quantity should be supplied than the standard amount, to provide margin of safety.

Materials such as film and transfer plates, and any other important items, can also be controlled.

When the run has been completed, the excess materials furnished should be accounted for. Any portion that has been consumed, if significant in amount, should be investigated. Such inquiries should be carried out in a constructive manner by the quality control man in cooperation with the foreman or superintendent in unusual cases. This will have a good effect on employees and will yield valuable benefits.

The materials consumed data are used further for inventory control recording purposes and can be costed out for the job-cost record.

Supplies, such as rollers, blankets, and other machine parts, should also be controlled both as to quantities in inventory and quantities used. A reasonable supply of replacement parts must be on hand for immediate use, but excessive supplies needlessly freeze working capital and may lead to losses from deterioration and other bad conditions. Many of the items are expensive and excessive replacements can be a serious drain. The report on machine parts used, in conjunction with the machine breakdown data, will keep management reasonably well posted on the carefulness of machine operators and the effectiveness of the preventive maintenance and quality control staffs.

#### Metal Trimming Machine Report

There should be a daily report on the activity of the cutting machine, and it can be useful in several ways. First, the output per hour can be checked with a standard to determine the efficiency rate. Poor results may be due to one or more of a number of reasons, which should be ascertained. Second, the report may be a double-check on charges to be made to customers for trimming.

#### Other Machine Reports

Dependent on the type of other equipment employed, management may desire other daily or weekly machine reports to determine the period production and efficiency of the machine and operator. In this category would be large machines such as a die-cutter, where a company is equipped for stripping, the camera, and the transfer-plate machines. In addition to the production records, these reports should also contain data as to supplies and materials consumed and spoiled. This information should be checked as to

efficiency of usage, and for recording the usage on the inventory control record.

#### Inspection Reports— Sheets Produced

Where sheets are independently inspected before delivery to customers, each inspector should prepare a daily report.

The inspector should record as a minimum, as to each order, the job number, the number of sheets, the quantity rejected, and the reasons for the rejections. These data may be recorded on the machine production report if desired, but some prefer a separate report. The rejection data may be used in the office to calculate the cost of the metal spoiled, for customer credit, and for the determination of company materials wasted and any possible charge back to suppliers.

The quantity of rejects and the causes naturally have significance. If the quantity is very small there is no problem. If it is considered excessive, then the causes must be investigated and the conditions corrected. At fault may be one or more of the factors of material quality, machine performance, or operator supervision, alertness, and competence.

#### Inspection Reports— Incoming Goods

Where quality control is exercised over incoming materials, and that is a recommended procedure, all materials are checked as to compliance with specifications. Variations from standards should be noted on individual reports covering each shipment. The report should disclose, in addition to rudimentary data such as name of shipper, and the quantity and type of materials involved, information as to the dissatisfaction, the quantity involved, whether or not the goods are to be returned, and whether or not a claim is to be filed with the shipper for price adjustment and expenses in-

curred, or a deduction therefor made from the invoice amount.

The reports should be prepared in a number of copies, one of which should reach the accounting department for such appropriate action as it should take, and at least one copy should be given to the receiving clerk who will check the quantities or weights.

Naturally, the variations from specifications should be discussed with the suppliers and the disposition noted on one copy of the inspection report. Review of the inspection reports by top management is recommended, to learn how active the quality control department is, what suppliers are involved, and what remedial action has been taken.

#### **Payroll Summary, Overtime Record, and Labor Turnover Analysis**

For every payroll period, or a larger period, management should receive a report dealing with these phases of payroll:

1. Number of employees, by departments.
2. Total man-hours, by departments.
3. Dollar cost, by departments and other categories as practical.
4. Average dollar cost per hour, normal time, for classifications in item #3.
5. Overtime hours, classified as in item #3.
6. Premium cost of overtime, similarly classified.
7. New employees added—name, category, salary or hourly rate, and explanation for addition.
8. Employees released—name, category, salary or hourly rate, and explanation of release.

Each phase of this report has a significance and importance of its own. The number of employees, man-hours, etc., has a relationship to production. The payroll data should be compared with that of the preceding period and such data as sheets or boxes produced and shipped and other relevant production data should be noted to provide a basis for determining the reasonableness of the labor force size in

relation to the output of the periods compared.

Overtime data should be carefully scrutinized. Sometimes it is inevitable because of the pressure of work. At other times, however, it may be due to poor scheduling, low production, stretching out of time to earn overtime pay, and other causes well known to management. Large overtime man-hours are always deserving of analysis as to reasons and, equally important, with respect to the output during the overtime period.

The report section dealing with labor turnover can be revealing. Replacements of help are always very costly and should be kept at a practical minimum. Releases for reasons other than lack of work should be investigated, if on a large scale or frequent, regardless of the recorded explanations. Help may leave because of disagreeable foremen, unsanitary conditions, and for other reasons of an uncomplimentary nature, but the explanations furnished management may not disclose the true reasons. Therefore, some independent inquiry is necessary, even including interviews of discharged employees before they leave.

Additions to manpower should be inquired into as to reasons, timeliness, rate of pay, etc.

#### **Inventory Report**

Periodically, weekly or monthly as practical, an inventory report should be prepared. It should contain the perpetual inventory (book) balances and physical inventory balances. The differences should be noted and unreasonable ones investigated.

All sorts of other data may be included in the report, pertinent to each major listed item. Here are several illustrations of helpful data:

1. Date of last use—this will disclose old items.
2. Average day's supply—this will disclose excessive quantities on hand or inadequacies.

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3. Amount in last preceding inventory—to disclose extent of change.
4. Commitments—materials ordered but not yet received—this should have a relationship to the amount on hand and the average rate of use.
5. Substandard items should be so marked—this may expedite action as to their reconversion or other disposition.

### Disposal of Containers, Waste, etc.

One of the most common sources of minor abuses is the inadequate control over the disposition of waste, and the disposal of deposit and non-deposit containers.

A rigid policy is recommended with respect to such disposals. They should be handled with the same care as to accounting as applies to the shipment of goods to customers. It is in order for the shipping clerk to supervise such disposals, unless other control is more practical in the individual case.

Where deposit containers are returned, a charge slip should be prepared from which the supplier will be billed. However, waste that is junked should be reported on a form for that purpose, indicating therein the nature of the waste, the quantity, by whom removed, and date. Since there will be a charge for such removals, a receipt could be obtained from the collector and attached to the report. Waste that has a salvage value and is sold should be similarly reported except that in this instance the price received should be reported. A charge slip, or invoice, or both should be prepared simultaneously for accounting and billing purposes.

Firm insistence that no disposals be made without reporting will be a deterrent to careless and improper removal of materials from the plant. Analysis of the items disposed of, and the quantities involved, may be revealing as to the extent of waste and spoilage not otherwise ascertained, and may also indicate that proper salvage values are not being realized on occasions. The psychological considerations as to care

of company property generally are highlighted in this control. The extent and expense of the control must, however, not be ignored.

### Other Internal Reports

All sorts of other internal reports, varying with the intensity of the managerial supervision, interest, and skill, may be utilized. Internal reports may be prepared for other departments of the business in addition to the production department. For example, a record of the backlog of customers' orders can be most helpful. Monthly reports of customer activity can be interesting to detect lagging customers and to spur on salesmen, if such personnel are employed. Every tool that management requires to permit it to do a good job (and the internal report is such a tool) should be provided.

### Other Cost Controls

The cost of every business activity can be ascertained from the company's records by having accounts for each activity. This is known as activity accounting. Management cannot be furnished information in any better detail than in which it is assembled.

Activity costs are disclosed in monthly or other period operating statements, in the order of the logical flow of the company's activities, so that the picture of the business operation is complete. Comparison of the activity costs are essential to the interpretation of their reasonableness and they should also be analyzed by their percentage to sales, cost of manufacturing, or other proper base.

In addition to the dollar costs of each department, certain unit cost statistics could be developed. For example, the metal storage costs could be used to develop the average cost of storing one skid of a customer's metal for one day. Some of these statistics will not necessarily result in immediate corrective action. Admittedly, knowledge of an unsound condition

will spur corrective action sooner than ignorance of it. Further, interest in costs creates an atmosphere of cost consciousness on the part of the whole organization and efficiency and cost reduction will progress far more rapidly in these surroundings than in places where complacency and inaction prevail.

Developing cost data is not too difficult but it requires patience, understanding, and the willingness to keep digging forever. In this connection I submit a quotation from an article that recently appeared in the Bulletin of the National Association of Cost Accountants ("Tailor-Making Cost Data for Specific Uses" by William J. Vatter, Professor of Accounting, School of Business, University of Chicago, August 1954 issue, p. 1691), as follows:

"It is a natural human trait to seek simple answers to our problems. We are constantly seeking the one factor that will serve as the answer to a whole group of puzzles . . . Not that there is anything wrong with the simple answer if it really fits the problem. The trouble is that, in our zeal to get the one true and simple answer, we frequently overlook the real nature of the problem.

Worse, when we are faced with a complex problem that demands more careful analysis than we are willing to give it, we get 'practical' about it—that is, we assume away some of the issues, simply because we do not know how to deal with them, or because we are unwilling to take the trouble to learn what we ought to know."

Here is a list of major cost factors that should be disclosed in operating reports:

The costs involved in these major activities, comprising labor, fringe costs, insurance, rent, and overhead including a share of administration expense, should be compiled on a departmental basis, where the departmentalization exists or can be distinguished:

Purchasing department  
Receiving department  
Metal storage

Storage of company materials and supplies  
Machinery maintenance, including outside costs  
Individual production department costs  
Shipping department  
Waste collection and disposal  
Building maintenance, including outside costs  
Labor fringe costs (may also be allocated to the various applicable departments)  
Overtime costs  
Spoilage and waste costs  
Delivery costs  
Selling expenses  
Office expenses  
Administration expenses  
Financial expenses

and any other expense analyses desirable in the individual situation.

#### **Launching a Cost Reduction Program**

Because of time limitations this aspect can be discussed only briefly, at best, and not in every conceivable respect. Enough points however are covered to be indicative of the entire scope of the program. The remainder can be ascertained when the occasion arises.

The program that is proposed is of necessity very much generalized. No one program would be suitable in all respects to any two companies here represented because of the differences in the number and calibre of their administrative and accounting personnel and in the state of development of their cost system and expense control procedures. There may be some here who need little advice, there undoubtedly are others who need a great deal. As in the prior discussion, the proposed program is addressed to the trade shop managers, the so-called small-business executives, and it starts from scratch.

Take from this program whatever you feel you can use. Revise any part of it, or all of it, to suit your particular

requirements. Add to it anything that you think will be helpful.

The proposed cost reduction program has two phases, the first being the initial investigation into all activities and their cost and necessity. This may result in a harvest of economies dependent on the fertility of the business soil and the effectiveness of the efforts made. The second phase will be constructed on the foundation provided by the first one, and will constitute a permanent program of cost reduction efforts to be ceaselessly and aggressively pursued by an ever-learning, ever-improving management.

There must be careful planning and preparation for this undertaking. There must be an inventory of administrative and supervisory personnel and a determination of the roles that could be assigned to them. One man should be placed in charge, and he may or may not be an owner. He should be of executive calibre and command the confidence and respect of the organization. Equally important, he must have the conviction from the outset that costs can be reduced.

### Initial Phase

The first phase of the program would involve these steps:

*As to the plant*, it should be determined that:

1. The machines are modern and efficient and of a size and type most suitable for the kind of work turned out.

2. Their lay-out and placement is logical in relation to the flow of materials and services through the various processes, and provides adequate space for storage and movement of materials.

3. They are properly maintained and that a preventive maintenance program is in effect.

4. A reasonable supply of repair and replacement parts are on hand.

5. The building, if owned, is well maintained so as to avoid abnormal repairs due to neglect.

6. The working conditions, such as light; air; cleanliness; toilet, rest room and locker facilities; and other such facilities come up to a high standard.

7. That modern material handling equipment is used and that because of the use of stacking equipment all air space that can be utilized is actually used.

8. The facilities for receiving and shipping goods are adequate for the needs, so as to minimize labor and equipment use and expedite the operations.

9. All available time- and labor-saving devices are utilized.

10. There is an organized program for fire and accident prevention.

Now, who is to do all of this, and any other services not here enumerated? It is likely that no one company executive is fully qualified, nor has the time and the objectivity to do this job. For that reason it is suggested that a qualified management engineer be employed solely to help carry out this project, to collaborate with company executives, to consult machinery and materials manufacturers, and to do everything else necessary to put the plant into the most efficient condition and provide the basis for keeping it that way.

### *As to manufacturing processes:*

Every manufacturing activity should be studied to determine how — not whether — it can be done more cheaply, more quickly, and with better results. The materials used should be analyzed as to whether they are the best, the most economical, and most practical for their use.

Who is to do this job? Perhaps it can be assigned to the department heads to carry out. Each one should be enlisted as in a campaign. In turn, each department head should enlist the

aid of the men in his jurisdiction. Written reports should be submitted to the executive in charge. A program of rewards for meritorious suggestions and achievements might be considered as a means of stimulation.

Machinery manufacturers and suppliers of coatings, inks, metal plates, and other materials could be consulted. Someone could be assigned to read one or more technical books on a particular operation, if available. Finally, where expedient, an outside expert could be called in to assist with any specialized phase.

*As to quality control:*

A chemist or other technician should be employed for quality control of all merchandise purchased. This control would apply to the specifications for materials for specific job use, and the checking of the materials received as to their compliance with specifications. He can inspect jobs in process for quality and consult with pressmen and others on problems as to which he can be helpful. There is hardly a quality-control man on a job who does not earn for the company more than his salary.

The quality-control man can work out the formulas for the amount of the specified materials to be used for each order. Any variation from this standard should be checked by him. It may disclose improper use of materials or undue waste and spoilage.

A plan for inspection of finished sheets should be instituted. This is desirable to retain customer goodwill and it is more economical than subsequent price allowances.

*As to control of inventory:*

Materials should be ordered only by means of a purchase order, properly approved. This will prevent overlapping orders and the necessary accumulation of excess inventory. Before approving a purchase order, an executive should be assured that the inventory is at such a level as to

require ordering, that the price and terms are right, that the specifications have been approved by quality control, and that everything about it is right.

Materials and machine parts should be stored in a stockroom and a duly approved requisition should be required for all withdrawals. This will provide a control at the source on materials used. The requisition form could, as a matter of convenience and efficiency, be combined with the materials used report elsewhere discussed. A perpetual inventory record should be kept and it should be checked at reasonably frequent intervals with actual counts, weights, and measures.

The perpetual inventory record could also contain a notation as to the quantity level at which the item should be ordered. This is an aid in insuring against running out of standard materials.

*As to personnel:*

Every department head should prepare a list of personnel and their duties. In certain departments, such as the office, it may be better to have each person list his duties. The assembled data could be analyzed to determine whether there is overlapping and duplication of work and personnel.

This type of work must be carried out diplomatically to avoid undue unrest and disturbance of employees.

Consideration should be given to hourly and weekly rates, subject to limitations by union contracts. This, too, is an area for study.

The maintenance of good relations with all classes of employees is of the greatest importance. It can make the difference between profit and loss. For that reason an executive of the company should be given the duty of studying this subject and reporting on what, if anything, should be done to bring morale up to the highest level. The rate of pay is not the only element of employee satisfaction. Many intangibles also enter into it. Incentives,

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opportunities for advancement, good working conditions, and recognition are only a few of these intangibles.

### *As to internal control:*

This is a most important control device and it concerns itself with the proper accounting for all the materials, labor, and services that the company buys and with the billing for all services performed and materials sold by the company. It is concerned with the protection of the company's assets.

It is partly an accounting problem and partly a procedural matter. Your own bookkeeper or controller, in conjunction with your Certified Public Accountant, can handle this matter for you.

Poor internal control may be the cause of many leaks and abuses, and expose employees to undue temptations. Plugging loopholes in this category alone may, in some one instance, avoid later disaster. It is also no unimportant matter to make sure that customers are billed for all services rendered, for the right quantities and at the right prices. One must be sure that extras that are chargeable to customers, and the cost of delays, are billed out. There should be no doubt that materials returned to suppliers, and costs that they should absorb for time losses and spoilage are all charged against their accounts.

### *As to cost records and controls:*

It has been pointed out to me that relatively few trade shops have completely integrated cost systems. Some executives, by instinct or otherwise, do not see the need for a cost system. That is a moot subject which I will not try to settle here. However, in the absence of a cost system, other practical methods of obtaining cost information can be utilized.

Production costs, for example, can be determined from careful observation and test runs, if dealt with seriously by personnel that have a satisfactory background and understand-

ing of what is involved. They can compute ideals for the consumption of coatings, inks, film, transfer plates, and other materials used. They can determine the normal rate of machine production per hour, as related to the size and gauge of the sheet. The cost of running a press, per hour, can be estimated by gathering the related costs. Your Certified Public Accountant can play a helpful role in the development and review of the many types of cost records. After all, costs must be determined in order to fix selling prices although I imagine that, where price lists are used, very few estimates, if any, are prepared during the course of a year.

It could be very profitable to employ a cost accountant to deal with the large variety of matters related to costs, expense controls, and in other worthwhile respects. Such a man, as with the quality control chemist or engineer, should be self-supporting as a minimum and, very likely, yield a profit on his services.

### *As to bookkeeping system and other clerical work:*

Here is a rich field for improvement. Many bookkeeping systems are obsolete and there is an enormous amount of duplication of paper work in many companies. Some offices are devoid of elementary bookkeeping machines, the cheap ones as well as the expensive ones. On the other hand, for reasons of economy, certain paper work that should be done is not done.

If your bookkeeping system and paper work have not been reviewed within the last five years, have your Certified Public Accountant do this for you, as a special engagement. Many benefits have been realized from such surveys.

### *As to scheduling orders:*

Scheduling production, particularly where short runs are involved, can well be the bane of management's existence if not handled expertly. Poor

scheduling can not only create traffic and storage jams but also cause idle time losses and customer dissatisfaction.

An ingenious aid in scheduling is the large wall chart. It provides quick and accurate control information in a most convenient form. This chart shows at a glance the status of orders, from which can be determined the prospect of complying with the scheduled delivery date.

Ways and means must be developed to insure that all materials required for the order will be available when needed. This can be accomplished by furnishing the purchasing department, inventory clerk, or whoever it is that is charged with this responsibility, a copy of each order. With this record to go by, there should be no loss of time due to failure to anticipate needs.

All of the foregoing actions, plus others not mentioned because of time limitations, constitute the initial phase of a cost reduction program and, simultaneously, a move for better controls.

All sorts of problems will arise in the course of working out a cost reduction program. They should be listed for attention, in the order of their importance, but in no event should the program be side-tracked. As the program moves on, increasing interest on the part of employees will be generated, and, dependent on the spirit and morale of the organization, worthwhile suggestions will be forthcoming from them.

#### Permanent Measures for Cost Controls

In the course of working out the cost-reduction program just discussed, suggestions were made for hiring, wherever there is sufficient volume to warrant it, a quality-control chemist or engineer and a cost accountant. They constitute the backbone of your cost-control department. Their work must be looked upon as being of the high-

est importance and it must be arranged that they receive the unreserved co-operation of the plant superintendent, foremen, the heads of the business, and all others whom they may have to deal with.

It should be their function not to just determine costs, and check on the correctness of prevailing standards, but, in cooperation with others in the organization, constantly seek out ways and means of reducing costs and pushing up production. They must keep in touch with the new developments in the fields of machinery, materials and processes. Trade publications should be subscribed to and read religiously. Suppliers' salesmen should always be questioned about what's new? Trade association activities should be enthusiastically participated in and furthered.

Top management, for its part, must learn the facts of modern business life. Sound management means cost control. They should provide incentives to their workers and set a good example themselves. They should encourage promising men to express themselves, to advance their technical knowledge by reading and by courses, and to make them feel that they are building for the company and for themselves.

Conferences should be scheduled at regular intervals where department heads, the cost-control section, and top management will discuss matters of broad interest. Cost controls, greater efficiency, improved quality, and better service are subjects which should frequently be on the agenda. Meetings of this sort can be invaluable, psychologically, in developing the finest morale amongst executives, and lesser-rank personnel too.

Your bookkeeping system must be adequate. The chart of accounts must be sufficiently extensive to permit the analysis of information in sufficient detail so as to permit the preparation of really practical and helpful operating data. Department heads should be furnished statements periodically

whereby they can judge the efficiency and profitability of their divisions. This device is one of the most worthwhile methods of building up the sense of responsibility of a foreman or department head. The reports should, obviously, be reviewed by top management and discussed with the individual department heads. This is an essential management function and one which, if properly carried out, will be highly rewarding.

As I come to the close of this discussion, I cannot help but wonder how many of you are raising questions in your minds such as

Who has the time for all this?

We do enough paper work now,  
how can we add more?

We're making little enough profit  
now, why add to the overhead?

Who can be sure it will pay off?

In response I can say only this—knowledge, energy, and managerial ability can be combined to surmount all of these obstacles. Top management should scrutinize their daily activities to ascertain how much time is devoted to matters of little consequence and which should properly be delegated to subordinates. This will free them for more important work. The same process should be carried out by all executives.

There isn't the slightest doubt in my mind that a survey will disclose numerous opportunities in many plants for the reduction of paper work on the part of the office staff and others. The time so saved can be devoted to matters that are not receiving attention.

Time will be saved by the efficient direction of the efforts of personnel. As a matter of fact, the capacities of individuals for accomplishment actually increase as their interest in their work grows. The efforts to bring executives and other personnel into closer touch with a company's objectives, the delegation of increased responsibilities, the provision of incentives and rewards, all of these and other factors will increase men's interest and, as if by magic, they will be able to increase their daily accomplishment.

The program prescribed need not be rushed so fast as to create confusion and have boomerang effects. By careful planning and organizing, and here again I must advance the cause of your C.P.A. who should be brought in as a consultant, the course to be followed can be laid out so as not to seriously overburden any executive. The addition of temporary or permanent personnel must be viewed in the same light as the addition of a machine to your plant—these people are going to produce something of value. The spirit of enterprise must not be permitted to become dormant, because that condition usually is fatal or, at best, brings about a state of unrewarding existence.

If you want to raise the earning capacity of your industry, and of your company in particular, you will not accomplish it by complaining about the terrible problems that confront you. That will only tend to create a condition of atrophy. Instead, tackle the problems vigorously with the weapons of knowledge through records and reports, with energy, and with managerial competence.



# What Is An Accountant?

By MARQUIS EATON, C.P.A.

*The author's thesis is "that the accountant is the custodian of a great science; that as a matter of history he is established upon the crest of a rapid current that will carry him to a position unsurpassed in importance, that he is a person with a multitude of problems yet to solve; that he does not even now fully appreciate himself or his discipline."*

THE points we are about to consider are suggested by the belief that the accountant is as yet a somewhat misunderstood individual—misunderstood by the public and even by himself.

When we misunderstand a person, our judgment of him misses the bull's-eye of reality by overshooting it or by undershooting it; we take him to be less or more than he actually is. I suggest to you that the accountant is considerably more than he is sometimes thought to be.

Accounting is a science rather than an art. There is accepted to be a science of medicine, and the practice of medicine is an art. In harmony with dictionary definitions of the word "science," I think it is not unreasonable to say that accounting is the science of which accountancy is the art.

The accountant, as a person, is controlled to an important degree by his science—that is, he must acquire stature or lose it as his science is great or small.

Is accounting as a science a small or superficial thing?

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As almost everyone knows, perhaps the first evidences of modern accounting are to be found in the business and household practices of ancient Rome. But before accounting as we know it could be developed the barbarians swept in, and the record is submerged for more than a thousand years by the Dark Ages. From the beginning of the Renaissance, however, the story starts again in the customs of the merchants and traders of the city-states of Italy. Then finally, in 1494, the first book to describe accounting in the form familiar to us was written by a Franciscan monk, Luca Paciolo.

The things Paciolo wrote about accounting were not claimed by him to be his own discovery. He referred to them only as the methods in use in Venice at the time. So between the fall of the Roman Empire and the year of Paciolo's book, accounting in all its fundamental outlines as we know it was discovered. It is not known whose product it was. Because of its clean, central proposition, it would be easy to believe the result was the conception of one man; but history seems to indicate that the final product was the result of gradual development, and that many minds contributed to it over hundreds of years.

You may have observed that I said accounting was "discovered," not that it was "invented." More than two hundred years after Paciolo's book, Sir Isaac Newton discovered and laid down his three laws of motion, one of which was that action and reaction are equal and opposite; that mutual actions between any two bodies are

always equal in magnitude but oppositely directed. Is it unreasonable to say that accounting was the discovery of a strikingly comparable dualism in all the transactions of commerce, and in all of the functions of the economic system? I do not think that it is unreasonable; accounting was not an invention, like writing, but a discovery of the most gigantic consequences. It was the discovery that in man's financial affairs there exists a balance of action and reaction. This is present by the nature of things, not merely through the accountant's invention of a method of recording.

Historians find to their satisfaction that the advancement of accounting has been prompted by the development of commerce, the private enterprise system, the corporate form of organization, absentee ownership, and the like. This may be true, but it is equally easy for me to believe that accounting was square abreast throughout the period, and was as much the cause as the product of these developments. How could they have occurred without accounting?

Just as Newton's laws of motion explained many mysteries once beyond the understanding of man, so does the sublime equation of accounting explain the basic elements of commerce so that men may manage, understand, and utilize them for their own good. And, without this kind of understanding, management and utilization, modern forms of government, the systems of property rights that provide their foundations, and the system of human rights that flow from them, could not have taken the shapes we know.

What was this magnificent discovery called? It was called "double entry bookkeeping." No more inadequate, insignificant, unimaginative, pusillanimous term could have been selected! The development of the science, its utilization by the public, and the acceptance of the profession which employs it, have all been cursed by this damning name. Can you imagine what

the acceptance of atomic energy might have been if it had been called "the popping of small particles?"

To confuse bookkeeping with the basic proposition which is accounting is like confusing some relatively common exercise in mathematics with Newton's law. It is like confusing the snapping of an electric switch with electricity itself.

#### **Popular Use of the Word**

The word "accounting," like the word "bookkeeping," is almost invariably used in the limited sense of meaning the activities which comprise the utilization and application of the central proposition which is accounting. So generally is the word "accounting" used in this sense that the basis of it, the sublime equation which is its core, the philosophy which is its light, may truly be said to have no name. It never gained a name like "Newton's law" or "Paciolo's law." We have only the word "accounting," used to describe anything from the activities of clerks to the rules we call "accounting principles," which are themselves nothing more nor less than standards or tools for applying the nameless equation.

When astronomers make some calculations based on Newton's law, no one confuses their activities with the strong, central proposition that guides them. But when an accountant casts up accounts, or interprets events in terms of accounts, that is thought to be all there is to it. The activity, the application, is considered to exhaust the matter. The pervading proposition which is the accountant's compass—that in financial affairs each part has its natural, inevitable, and equal counterpart—is not known by many even to exist.

But, it may be asked, what of it? Millions can live and die without even hearing of Newton's law and without being much worse off. Is this not true of accounting? Isn't it enough that a

few experts know about it and guide everyone else?

### Concern to Everyone

The difference lies in the number who need to use the product. Income, for example, is an accounting concept, and is determinable only by the accounting process. Income is of concern to everyone—astronomy is not. As a matter of fact, one school of psychologists holds that income is the greatest known motivator of human conduct. Thus accounting, as a subject of learning, is to some extent proper for the consideration of every educated person.

Is accounting a science of sufficient breadth, and depth, to support a profession of respectable stature? I say it is. The understanding and imaginative application of it easily leads the accountant into the central control rooms, where the big decisions are made, and where the general orders are issued.

We can reason that in a very real sense of the word, the accountant is what his science is. If his science is great, then he is great, or is destined to become great. We may reason further that if his science is, as an historical matter, only recently discovered and only partly developed, then the accountant is an individual who might be said to be in "mid-flight."

That the accountant is in mid-flight requires for its proof only the briefest glance at the past and at some of the conditions of the present.

Not so long ago, within the lifetimes of many readers of this article, an accountant was nothing more nor less than an expert in accounts, and accounting itself was utilized narrowly and unimaginatively in the historical recording of transactions. Accountants were few in number.

### Present State of Affairs

Only a little reference to things as they are now will serve to show how

swift a current we ride. As of this moment, to take one example, we are a nation in first place in world affairs. The nation, in turn, depends for its strength and vitality upon a system of revenues which is constructed almost wholly upon the accounting concept of "income," and a system which is dependent for its successful functioning upon thousands of accountants in the service of government and in the service of taxpayers. It is unthinkable that the nation could have developed its great strength without great revenues. And it is equally unthinkable that these great revenues could have been brought forth without the science of accounting. It is unnecessary to dwell upon the expanse and complexity of the economic structure which must exist for these revenues to be withdrawn, or upon the dependence of that structure upon accounting. We need not dwell upon the great numbers of accountants, in public service and in industry, who administer this science, nor upon the great university schools of accounting which make the profession possible.

In spite of this impressive record, is it reasonable to suppose that everything that may happen has happened, and that we can now contemplate a professional scene which has reached full growth? Let us see whether we can illuminate that question by an example.

I have seen this definition of controllership: "We can define controllership as the coordinating function in a business, working in a detached and unbiased way, and charged with the responsibility of planning for profits and providing suitable profit control machinery. It is the investigative, analytical, suggestive and advisory function, studying the business at all points all the time, and formulating what the proposed practice should be with reference to sales and production control as well as financial control, which, when accepted or modified by the executive management, becomes the ap-

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proved practice for use by the performance or 'line' function." Other definitions also emphasize the controller as a staff officer whose role it is to assist the executive management in making its decisions.

### **Inscrutable to the Layman**

Now consider this. I have laid claim that accounting is a great science. To the layman it is also an inscrutable science. Between the great body of difficult fact, as expressed in accounts, and those who need to know the facts and act upon them, stands the professional accountant—whether he be functioning as controller or otherwise. There is seldom a situation in which it is possible to present all the facts. In selecting those to be presented, the accountant inevitably serves also as interpreter—by the mere act of selection. And again, by the mere act of selection, he must often determine upon a course of action, based on all the facts as only he can know them, and select for practical presentation and emphasis the facts that inescapably indicate the course that only he could have charted.

I do not mean to suggest that accounting is all there is to business, for to advance such an argument would be to champion an obvious error. But if the principal material of thought in a particular problem is accounting, can anyone but an accountant make an intelligent decision — no matter how much that person may be assisted by an accountant? I am not implying that all business decisions must be made by accountants. I am proposing only that in the case of many business decisions those who make them should be accountants, and that is quite a different thing. It is even now the case that any business beyond the very smallest can be visualized in profile or in motion only in terms of accounts. This is being acknowledged through the selection of accountants as presidents of an increasing number of cor-

porations. The men so selected had added something to their equipment besides accounting, but the tendency would seem to be natural.

But, without worrying the point any further, is it not logical to assume that controllership, as a state of mind and as a professional ability, has not yet found its ultimate level, and that when it does it will be far above the level now commonly believed proper?

This example of the controller is but one of many that might be put forward in support of the proposition that, if the accountant's science is by its nature at the core of many things, then the accountant as a person must expect to play a leading part in business and public affairs. The accountant, now in mid-flight, has the promise of a glowing future; his profession is in the full flood of its making.

The accountant is a person who is further characterized by the fact that he faces many unsolved problems. Some of these are technical and relate to the advancement of the science as such; but some have to do with the composition of the profession which employs the science, and some are moral problems arising from the public obligations which attach naturally to any professional skill. I will comment only on the last two.

Fifty years or so ago, as we have noted, the word accountant meant one thing—an expert in accounts. By the present time, we have attained some specialization, as is evidenced by the several names applied to accountants: internal auditor, controller, public accountant, etc. The avenues of specialization so far recognized have reached such proportions that it would require a godlike creature indeed to master them all. But much further specialization is inevitable.

It is the nature of a great science that it should be widely useful and lend itself to adaptation in many situations. It is highly improbable that we have seen more than the beginning of the specialization that will be prompted

by these characteristics of our science. If we consider only the public accountant, it is easy even now to feel the pressure of this tendency. Income tax accounting is virtually a full-time career if it is to be practiced in an enlightened way. What about government regulation, such as SEC requirements? What about management advice, industry differences, costing, machine applications, auditing, governmental accounting, rate making, and many other things? Several of these cry for specialization as of this moment. If we can foretell our future from reference to other professions, we will have specialization as between individuals, or departments, within a single firm, and we will have specialization as between one firm and another. But, still consulting the record of the other professions, we will retain the general practitioner who will deal with the usual run of uncomplicated matters, and will serve the small client who may have complicated problems but who is unable to afford the specialist.

#### Pressure Toward Specialization

We should not resist this pressure toward specialization, but welcome it in the interests of making our science bear the most abundant fruit.

Accounting in all of its ramifications is such an enormous thing that we must cut it into smaller portions so that the individual accountant can tackle a piece with the reasonable expectation of being able to digest it within one lifetime. Unless we do this, accounting cannot achieve the useful adaptation to numberless situations, which is its potential.

How is this specialization to be administered and acknowledged? Through specialized courses in the schools, and specialized degrees, as in the case of engineering? By special examination and accrediting by the professional societies themselves, as in the case of medicine? By state ad-

ministered procedures, as in the case of the CPA certificate? Or merely by self-designation, as in the case of some branches of management consulting work? Rather than trust to an accidental and unguided result, should not the profession face this problem and seek to reason out the best measures for use in the circumstances?

#### Unresolved Ethical Problems

As we adapt our science for careful application in an ever-increasing number of places, we encounter problems of ethics that we have not begun to resolve. Our thinking to date has been evidenced mainly in a code of ethics for the practicing public accountant, and in this we deal with him chiefly in his capacity as auditor.

In auditing, the findings and report are the result of unilateral procedures. We have set up standards of disclosure and independence which are intended to insure as far as possible an appropriate integrity on the part of the accountant when he acts alone in relation to the accounts.

But accounts are used and are useful in many situations in which the unilateral approach is not the intended system and where everyone understands that it is not. Should the accountant carry over into these areas the same standards of objectivity and independence that are so appropriate in auditing? If he does carry these with him, is he not in fact limiting the usefulness of his science by refusing to adapt it to the accepted standards of the situation in which it would be applied?

Accounting is an economic, not a mathematical, science. Its results are characterized by opinion. Few of them can be put forward as ultimate, indisputable truth. Accounts are often used by two opposed parties each of whom is trying, by negotiation or otherwise, to prevail. Examples are controversies between the citizen and his government in regard to income taxes, and

## *What Is an Accountant?*

some disputes between management and labor.

Justice as a philosophical theory and justice as a practical matter, are two different things. In man's practical affairs he has been able to produce no better system than the one which contemplates that if each of the two parties to an action does his ethical best to win before an impartial tribunal the truth will emerge and justice can be done. It is forbidden that either side will lie, cheat, or steal. But, since justice is very much a matter of opinion, it is expected that each side will present the facts in the light most favorable to it.

Is the accountant doing wrong if he espouses his client's cause and approaches his work in this frame of mind? If this is not wrong, then the suit of ethical clothes he wears for the purpose has a pattern and color that may differ materially from the one he wears in his auditing work. Because we have not thought this thing through, we see examples of the accountant apparently trying to apply his ethics of auditing in other work where this may be neither possible nor desirable.

New questions of morals are presented to the accountant when he serves in each of his almost numberless capacities. In each he has the problem of being decent and being practical. If one has to be sacrificed, he saves his integrity and lets the practical go. The community itself, moreover, has various codes of morals. They differ from one class of society to another, from one part of the individual's life to another. They even differ, as we all know, from one industry to another. The accountant cannot always accept the ethics of his client, and sometimes not even the ethics of the business community. Eventually, in this area of ethics, we must work out formal standards for ourselves on a much broader base than any we have as yet attempted.

These paragraphs should not be taken to indicate that I am ready now to say that the accountant should have multiple ethical standards from which to accommodate himself to differing circumstances. I present the proposition only to suggest that we have many problems yet to consider.

### **Extreme Self-Criticism**

Another mark of the accountant, if we can judge him by the activities of his professional societies, is that he is self-critical in a most extreme way. We are critical of ourselves on every score—our organizations, our techniques, our science, our ethics; and out of this self-criticism has come improvement, and the young profession has traveled quite a distance in record time. May we never abandon this wholesome habit of frank self-examination!

But with it, too, has come some failure of self-appreciation. As a class, accountants have an inferiority complex. If we had no such complex, we should see more accountants in the lead, or close to it, in the affairs of business and government where the solutions to problems call for the accounting-trained mind. Do we often find them there? Let us see.

In business we find, of course, the most extensive use of the accountant, and in some business organizations the accounting-trained mind is utilized to the fullest degree possible at the present stage of history. But in many firms, particularly in the smaller ones—this enlightened condition is largely or partially absent. And to this the gatherers of statistics attribute an impressive number of the business failures, with their attendant economic loss and waste of effort.

But it is not in business itself that we find the least appreciation of the habit of mind that characterizes the trained and experienced accountant. For extravagant examples of this kind we should consult the institutions, and

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## *What Is an Accountant?*

the activities of people, in which the profit motive is absent. And, of course, the largest of these is government.

When Walter B. Pitkin devoted nearly six hundred pages to his *Short Introduction to the History of Human Stupidity*, how did he manage to omit examples of the staggering imbecility we find in governmental affairs because of the absence of the accountant's mind? Read the records of legislative debates on issues of such importance as to reach nearly all of us. Compare with what you learn there the method of approach to the problem that would have most appealed to the accounting-trained mind. Observe how bare the record usually is of the really vital information necessary to a sound conclusion—information of a kind that could and should have been provided and considered. Observe the small and obsolete machinery government has for furnishing information of this kind. Observe, too, how little demand there seems to be for it from those who have the responsibility to make the decisions. Witness the failure in a multitude of instances to make any comparison whatever of cost, with the social benefits sought to be achieved by some action of government. Witness the wasteful measures provided to seek the ultimate of social good when ninety percent of it could have been accomplished at ten percent of the cost. Intelligent results would in many cases be insured by nothing more than an exercise in cost accounting. How often do you see a really skillful attempt to determine costs in advance for comparison with estimated results? How often do you see a later calculation of costs for comparison with the results actually being realized? How often do you see such costs used to condemn governmental functions which, though once beneficial, have outlived their relative usefulness? Do you know of any other human activity which is run on the basis of determining first what is going to be spent, and then looking

around for the funds to cover the spending? What a strong country we have, which can, and does, tolerate a system in which income is produced, by industry, through the use of reasonably adequate accounting methods, and then is extracted and spent by government through the use of no accounting method worthy of the name. Yet governmental affairs are the great affairs of men—because any action there is likely to involve more people and money than any business could contemplate.

### **The Accountant's Duty**

We must not view examples of this kind with the thought in mind that the persons involved are properly subject to our censure. We are the ones to blame. It is the duty of those skilled in accounts to advance their use into all proper places, not the duty of those who know nothing about them to insist on it.

I have used this example to illustrate that in some degree the accountant has, in fact, an inferiority complex. How often do we see accountants taking an appropriate part in these affairs? How much of our thinking is controlled by the belief that we should only provide information, and advise, but that others with some intangible but greater aptitude should make the decisions?

### **Custodian of a Great Science**

But this is enough of an attempt to draw a word picture in answer to the question, What is an accountant? We have reasoned that there is cause to believe that the accountant is the custodian of a great science; that as a matter of history he is established upon the crest of a rapid current that will carry him to a position unsurpassed in importance; that he is a person with a multitude of problems yet to solve; that he does not even now fully appreciate himself or his discipline. We might summarize this still

## *What Is an Accountant?*

further by saying that the accountant is a member of a profession fantastically strong, but as yet with little faith in its strength.

Many of the great things of the past have been things of material; many of the great things of the future will be things of the mind. And of these the mind trained in the symmetry and balance of accounts will produce a flattering share. Not of thoughts in relation alone to accounts themselves, but thoughts in regard to great public and business affairs—thoughts that one day will come to be accepted more

willingly as going to the roots of financial and social reality.

What more could a man ask than to lead a life in the service of a great science, to do his part to carry it from its frontiers toward a still greater usefulness in the service of his fellow man, to face challenging problems of true importance, to join with his colleagues in professional societies and feel the companionship available to him there, to contribute the full strength of his mind, his energy and his loyalty to a task offering such rewards?



### **Book Reviews**

(Continued from page 323)

The authors have taken cognizance of the fact that many firms avoid distribution cost analysis work because of the expenses involved in collecting this data. The authors have carefully inserted in Section IV a discussion of Short Cut Methods and Marginal Analysis of Distribution Costs—which should prove helpful to these firms.

In Section V, the managerial aspects of distribution cost analysis are presented. Cost analysis in most instances is useless unless there is some standard by which to measure the performance. In this section, the authors have indicated by the use of Standards, how management may use the distribution cost data to measure the effectiveness of the

marketing division of a business firm.

In retrospect, this book has been one of the most wholesome contributions to the fields of accounting and marketing literature in some time. It is practical. It is well-balanced, written by the coordinated efforts of a marketing research director and a certified public accountant. It contains illustrations of a complete distribution cost analysis program for a manufacturing concern.

JOHN J. W. NEUNER

Bernard M. Baruch School of  
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# New York State Tax Forum

Conducted by BENJAMIN HARROW, C.P.A.

## Checking on Income Payments to Individuals

Two months before April 15, the due date of the individual income tax return, employers are required to file with the Income Tax Bureau reports of amounts paid to employees during the past year (Forms 105 and 106). If maintenance is a part of the individual's compensation that is included in the report.

Income from partnerships, trusts and estates is also reported, as well as certain payments of rents, bond interest, mortgage interest and income from leases on oil wells.

This income information is matched against the individual's own tax return by machines on a punched-card process. This operation enables the Bureau to detect delinquency and discrepancies in amounts reported.

## Reporting Nontaxable Income

Some income may be nontaxable both under the Federal law and the State law. For example, the State

exempts from tax unemployment insurance benefits, social security pensions, property acquired by will or inheritance, life insurance received by reason of the death of the insured, benefit payments under the sickness disability benefits law paid under a plan of insurance, workmen's compensation awards, compensation for active service as a member of the armed forces, death benefit payments by employers made under a contract by reason of the death of an employee but limited to an aggregate of \$5,000 to all beneficiaries, and stock dividends.

This year the State Tax Commission required each taxpayer to report all tax-exempt income on the tax return. (Schedule D, page 3, Form 201 or item 23 of Form 200.)

## The Deduction for Taxes

The law (Section 360.3) provides generally for the allowances of all taxes as a deduction from gross income, except estate, gift and income taxes paid to the United States, any state or its subdivision, or to any foreign government. In spite of this broad provision, many taxes that a taxpayer thinks he pays are not allowed as a deduction, because the tax is not expressly imposed upon the taxpayer.

Real property taxes are deductible by the owner of the property. Automobile registration fees are ordinary taxes (Reg. Art. 141), but the \$5 extra service charge for special low numbers is not a tax and not deductible. The New York State gasoline tax is deductible, but the federal gasoline tax is not since the latter is levied on the distributor. The consumer-taxpayer technically pays that much more for the gasoline. The New York City automobile use tax is deductible.

Federal excise taxes on telephones, on transportation, on club dues, on

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Mr. Harrow is a past Vice-President of the Society. He is a past Chairman of the Committee on Publications and of the Committee on State Taxation. He is also a member of the Institute's Committee on Federal Taxation.

Mr. Harrow is engaged in practice as a certified public accountant and attorney in his own office in New York City.

admissions and on safe deposit boxes are all deductible. They are all expressly imposed upon the taxpayer.

The cigarette taxes, federal, state and city, are not deductible. They are all imposed upon the manufacturer or distributor and not directly upon the purchaser or consumer.

The social security tax paid by the employee is not deductible because it is classified as an income tax. Nor is the self-employment tax to provide social security benefits for the self-employed deductible.

The nonresident subject to the New York State income tax may deduct taxes only where they are connected with the production of New York income.

### New York City Sales Taxes on Services

The 1955 Legislature<sup>1</sup> has restricted somewhat the power of the city to tax services. Utility services such as gas, electricity, telephone, etc., are taxable. Food, drink at restaurants and bars including cover charges, minimum charges and entertainment charges are taxable where the charge to the patron is one dollar or more.

Services of printing are taxable and also the furnishing of information services. The latter includes collecting, compiling or analyzing information of any kind and furnishing reports to other persons.

The effect of the act is to bar the city from extending the tax to cover services not taxed by the City before January 1, 1955. That eliminates the possibility of taxing repairs, improvements and maintenance services to real and personal property, laundry and dry cleaning services, etc.

### Campaign Against Tax Evaders and Delinquents

George M. Bragalini, the new Presi-

dent of the State Tax Commission has announced a statewide drive against income tax delinquents and evaders. The drive will be systematic and sustained. The Bureau plans also to tighten up methods of detecting excessive deductions. Commissioner Bragalini intends to be lenient with those taxpayers who make voluntary disclosures. He proposes to enforce vigorously the provision in the law requiring employers to file information returns. Commissioner Bragalini says that the matching of information returns with individual reports results in the recovery of millions of dollars of additional revenue each year.

### Inspection of Federal State Returns by State Officials

Section 55(b)(2) of the 1939 Code requires the Internal Revenue Service to permit any official, body or commission lawfully charged with the administration of any State tax law, to inspect federal income tax returns if the inspection is for the purpose of such administration or for the purpose of obtaining information to be furnished to local taxing authorities. Section 6103(b) of the 1954 Code is to the same effect. The inspection is permitted only upon written request of the Governor of a state.

There is no provision in the federal revenue law requiring a taxpayer to allow state officials to inspect his federal returns nor does the law protect him from such inspection. Some state statutes (not New York) require the filing of copies of federal returns in conjunction with the filing of local returns.

A revenue ruling<sup>2</sup> holds that such statutes do not violate the provisions of Sec. 55(f) of the 1939 Code and presumably Sec. 7213(a) of the 1954 Code, the provision against divulging information submitted on an income tax return.

<sup>1</sup>L. 1955, Chapter 246, effective April 16, 1955.

<sup>2</sup>55-238, I.R.B. 1955-18.

### Traveling Expenses—Personal or Business

A taxpayer engaged in investing in independently-produced pictures released in the United States wanted to take a trip to Europe to explore the general possibilities of making more favorable investments in European films. He requested a ruling on the deductibility of expenditures incurred in making such a trip. The Internal Revenue Service ruled<sup>3</sup> that without an existing right or interest resulting in the production of income such expenditures were nondeductible personal expenses. The State would undoubtedly rule the same way.

### Taxability of Fringe Benefits

This is the subject of an excellent article in the March, 1955, issue of Taxes by J. Henry Landman, Professor of Tax Law at the New York Law School. Professor Landman's concern is with the taxability of such benefits to the employee. "Insofar as they constitute compensation in a form other than cash", they constitute taxable income. The Treasury has however considered them tax-free if they are given for the convenience of the employer. That rule is simply an administrative test to be applied where it is not evident that the benefits represent compensation.

The article includes a discussion of a number of specific fringe benefits. Board and lodging is now covered in the 1954 Code.<sup>4</sup> The value of such benefits is excluded from gross income only if the meals are furnished on the business premises of the employer and in the case of lodging the employee is required to accept such lodging as a condition of his employment.

Group life, health and hospitalization premiums were not taxable income

to the employees until 1950. On February 23 of that year the Treasury issued Mem. 6477<sup>5</sup> holding that premiums paid by employers are not additional income if they provide only current term insurance and do not have paid-up or substantial values. On permanent group life insurance policies, premiums are taxable to the employees unless rights are forfeitable upon separation from service.

Sec. 105(a) of the 1954 Code provides that amounts received by an employee through health insurance are included in gross income to the extent that they are attributable to contributions by the employer which were not includable in the gross income of the employee, or where the premiums were paid by the employer.

A 1953 Revenue Ruling (181) held that premiums paid by a charitable organization to purchase annuity contracts for its employees are not taxable as income to the employees. The employees will be taxed on the annuity payments when they receive them. This ruling should be of particular interest to college professors.

Section 104 of the 1954 Code excludes from taxation employee benefits received from accident or health insurance and from workmen's compensation. Professor Landman notes that there is much confusion in this area on the meaning of insurance and the refusal of the Treasury to follow the *Epmeier* case<sup>6</sup> which held that in a private insurance plan, payments received from an employer by an employee who is absent because of illness or other disability are not taxable.

Section 74 of the 1954 Code attempts to clarify some of the confusion with respect to the taxability of prizes and awards. Generally they are now to be included in taxable income. An exception is made for prizes and awards made primarily in recognition

<sup>3</sup> 55-237, I.R.B. 1955-18.

<sup>4</sup> Sec. 119.

<sup>5</sup> 1950-1 CB 16.

<sup>6</sup> 199 F. (2nd) 508 (CA-7).

of religious, charitable, scientific, educational, artistic, literary or civic achievement. Even then the recipient must be selected without any action on his part to enter the contest, and he must not be required to render substantial future services as a condition to receiving the prize.

Severance payments to an employee constitute taxable income. So also are payments to employees on military leave. Courtesy discounts however are not taxable income. Professor Landman says that "the rationale seems to be that these discounts are intended to promote health, goodwill, contentment and efficiency."

Entertainment expenses are deductible as ordinary and necessary expenses of a business and do not constitute income to those entertained. That is so even if the entertaining is in one's home. Entertainment and recreation for employees are not taxable to them since they are intended to promote health, goodwill, contentment or efficiency.

While supper money paid to employees who work after regular hours is not taxable, no deduction is allowed for the cost of the meal to the employee if the employee receives a bonus for overtime work. Free lunches served to employees are not taxable.

The expense of sending a representative to a convention is deductible as a business expense, but not if it is not related to the taxpayer's business. The employee is not deemed to be earning additional income, since he is merely performing his duties as an employee.

A Revenue Ruling (54-147) states that transportation allowances to employees constitute taxable income. However the employee may deduct his travel expenses if the work away from home is temporary. If the center of activities is of a permanent nature, it becomes the tax home of the taxpayer and travel expenses are not deductible. The Treasury has also ruled that a tax-

payer must be away from home overnight to deduct unreimbursed travel expenses. Such expenses include living expenses.

With respect to expenditures for uniforms the Treasury now holds that a deduction is allowable for the cost of wearing apparel that is specifically required by and used solely in the taxpayer's business and is not adaptable for nonbusiness life.

Ordinarily an employer who owns and maintains an automobile for the use of an executive in the conduct of his business may take the deduction for appropriate expenditures, and the employee is not subject to tax for the use of the automobile. However, to the extent that the employee uses the automobile for personal uses he is in receipt of taxable compensation. In the latter case the employer is not entitled to deductions for operating expenses or depreciation, but they would be deductible as compensation.

The employee who uses his own car in connection with his employment may not deduct nonreimbursed expenses in determining adjusted gross income. He may deduct such expenses in lieu of the standard deduction. If the employee is away from home over night he may take the deduction in determining adjusted gross income.

Employment agency fees are deductible and, of course, if the employee is reimbursed for such fees, he receives taxable income. Christmas bonuses are generally taxable as additional compensation.

#### Marital Deduction—Estate Tax

Part of the assets of an estate consisted of a \$50,000 life insurance policy. One-third of the principal amount qualified for the marital deduction. During his lifetime the decedent had borrowed \$16,711.72 on the policy. The loan had been paid by decedent's wife and the decedent had given her

a note for the loan, assigning the policy to her as security for the debt. Under Section 812(e)(1)(A) of the 1939 Code<sup>7</sup> the Commissioner allowed the marital deduction for property interests passing to the surviving spouse, but held that in arriving at the value of such interest any encumbrance should be taken into account under Section 812(4)(1)(E)(ii) of the 1939 Code<sup>8</sup> and therefore a pro rata amount of the indebtedness to the wife should be applied to the marital deduction. The Tax Court upheld the Commissioner<sup>9</sup>. The indebtedness to the wife constituted an encumbrance of the policy.

#### Another Marital Deduction Case

A wife's share in her husband's estate was subject to a 2% State inheritance tax. Under Section 812(e)(i)(E)(i) of the 1939 Code<sup>10</sup> the value of the marital deduction must take into account the effect of estate and inheritance taxes on the net value of the surviving spouse's interest. Under Section 813(b), Pennsylvania inheritance taxes are allowed as a credit against the federal estate tax. Under Pennsylvania law no part of the federal estate tax is apportioned to a share of the estate which is deductible in computing the net estate. No part of the federal estate tax was allocable to the portion of the estate making up the marital deduction. The estate argued that the credit for the Pennsylvania tax represented an imposition of the federal estate tax from which the wife had to be relieved by apportioning the tax on her inheritance to the other beneficiaries. There was no law in Pennsylvania in 1948, when the decedent died, which

provided that the incidence of the tax should shift under such a situation. The Tax Court<sup>11</sup> held that the marital deduction must be reduced by the inheritance tax on that interest.

#### Life Insurance Proceeds—Liability for Unpaid Taxes

The United States Court of Appeals, Seventh Circuit, held recently<sup>12</sup> that the widow of an insolvent decedent was not liable, as the recipient of insurance proceeds, for his unpaid income taxes.

The decedent died insolvent in 1948. He owed federal income taxes in the amount of about \$65,000 for prior years. At the time of his death there were five life insurance policies in effect. His wife was the named beneficiary in each policy. After the proceeds were paid to her, the United States brought an action to recover the proceeds to the extent of the tax claim. One specific policy was in issue. It had been in effect for fifteen years and the decedent had a reserved right to change the beneficiary. The District Court had granted a motion for summary judgment with respect to this policy.

On appeal the Court held that the beneficiary as recipient of the proceeds of the policy was not liable for the tax as a transferee under Section 311 of the 1939 Code.<sup>13</sup> The weight of authority, said the Court, was against that contention. It relied on a Second Circuit case<sup>14</sup> which had reversed a decision of the Tax Court,<sup>15</sup> in favor of the government. The Court said that

"in no sense were the *proceeds* ever property of the decedent-taxpayer. Under the

<sup>7</sup> Sec. 2056(a), 1954 Code; Sec. 249-S.4 N. Y. Tax Law.

<sup>8</sup> Sec. 2056(b)(4)(B), 1954 Code; Sec. 294-S.4(e) N. Y. Tax Law.

<sup>9</sup> *Estate of Fielder J. Coffin v. Commissioner*, T. C. Memo, Dkt. No. 42391—December 20, 1954.

<sup>10</sup> Sec. 2056(b)(4)(A), 1954 Code; Sec. 249-S.4(e) N. Y. Tax Law.

<sup>11</sup> *Estate of Edward V. Babcock v. Commissioner*, 23 T. C. No. 111, February 18, 1955.

<sup>12</sup> U. S. v. *New*, 217 F. (2d) 166, rev'd. U. S. D. C. Ill., 123 F. Supp. 312.

<sup>13</sup> Sec. 6901, 1954 Code.

<sup>14</sup> *Rowen v. Commissioner*, 215 F. (2d) 641, September 9, 1954.

<sup>15</sup> 18 T. C. 874.

policy contracts the decedent never had a right to receive the proceeds. And since at his death the policies were not payable to his estate, the *proceeds* of the policies never passed to his estate and *as to the proceeds* the beneficiaries did not take as legatees or distributees of his estate."

Apparently the inclusion of the insurance in the gross estate for estate tax purposes does not subject the proceeds to a transferee liability for income tax. It would subject it to any estate tax liability. It should be noted that if a joint income tax return had been filed, the government would have succeeded in an action against the wife, since the liability on a joint return is joint and several.

#### Deduction for Property Previously Taxed—Estate Tax

Under Section 812(c) of the 1939 Code<sup>16</sup> a deduction from the gross estate is permitted generally for property previously taxed. The deduction is an amount equal to the value of any property transferred to the decedent by

gift or inheritance within five years prior to death, on which a gift or estate tax was finally determined and paid.

The construction of this section was before the Ninth Circuit in a recent case.<sup>17</sup> In 1946 the decedent had received a gift of stock. Because of the \$3,000 annual gift tax exclusion and the \$30,000 specific gift tax exemption, no federal gift tax was actually paid. The decedent died in 1947 and the estate contended that the stock was not subject to an estate tax since it was previously taxed property. The Commissioner disallowed the deduction contending that because of the exemptions no gift tax had been paid and the deduction did not come within the provisions of Section 812(c). The Tax Court upheld the Commissioner.

The Ninth Circuit affirmed the Tax Court. It held that the taking of exemptions left untaxed the transfer of property equal to the exemptions and therefore such property was subject to the estate tax.

<sup>16</sup> Changed by Section 2013, 1954 Code.

<sup>17</sup> *Estate of Arthur A. Schmidt v. Commissioner*, Ninth Circuit, No. 13760, February 17, 1955, affg. Tax Court, 19 T. C. 54.



# Accounting at the S. E. C.

Conducted by LOUIS H. RAPPAPORT, C.P.A.

The SEC is proposing to revise Form S-1 which is the Commission's principal registration form under the Securities Act of 1933. The Commission has circulated copies of the proposed form and has asked for comments on or before May 27, 1955. If any readers have any comments or suggestions regarding the Commission's proposal, we feel sure the Commission would be glad to receive them even though they are sent after the date suggested in the Commission's release.

The proposed revision makes no changes of substance in the requirements for financial statements and supporting schedules but there are important revisions in the summary of earnings. As in the present form, the summary of earnings would be Item 6 of the revised form. The text of Item 6 as revised and the related instructions follow:

## *Item 6. Summary of Earnings*

Furnish in comparative columnar form a summary of earnings for the registrant or for the registrant and its subsidiaries consolidated, or both, as appropriate, for at least each of the last five fiscal years of the registrant (or for the life of the registrant and its immediate predecessors, if less) and for any period between the end of the latest of such fiscal years and the date of the latest balance sheet furnished, and for the corresponding period of the preceding fiscal year. An analysis of earned surplus shall be furnished for each such fiscal period of the summary as a continuation thereof or elsewhere in the prospectus. In connection with such summary, in type as large as that used generally in the prospectus, whenever necessary, reflect information or explanation of material significance to investors in appraising the results shown.

*Instructions.* 1. The summary shall cover a representative period and, sub-

ject to appropriate deviation to correspond to significant characteristics of the registrant, the following items shall be included: net sales or operating revenues; cost of goods sold or operating expenses (or gross profit); interest charges; income taxes; net income; special items; net income and special items. The summary shall reflect the retroactive adjustment of any material items affecting the comparability of the results. See paragraph (b) of Item 21.

2. If common stock is being registered, the summary shall be prepared to present earnings applicable to common stock. Earnings per share and dividends declared for each year of the summary shall also be included when appropriate.

3. A registrant which is a company engaged primarily (i) in the generation, transmission or distribution of electricity, the transmission or distribution of gas or water or in furnishing telephone or telegraph service or (ii) in holding securities in such companies, may, at its option, include a summary for a twelve months period to the date of the latest balance sheet furnished, in lieu of both the summary for the interim period between the end of the last fiscal year and such balance sheet date and the summary for the corresponding period of the preceding fiscal year.

4. A registrant may, at its option, show in tabular form for each fiscal year or other period, the ratio of earnings (computed in accordance with generally accepted accounting principles after all operating and income deductions, except taxes based on income or profits and fixed charges) to fixed charges. The term "fixed charges" shall mean (i) interest or amortization of debt discount and expenses and premium on all indebtedness; (ii) an appropriate portion of rentals under long-term leases and, (iii) in case consolidated figures are used, preferred stock dividend requirements of consolidated subsidiaries, excluding in all cases, items eliminated in consolidation. In the case of utilities, interest credits charged to construction should be added to gross income and not deducted from interest. The pro forma ratio of earnings to fixed charges adjusted to give effect to the issuance of securities being registered and to any presently proposed issuance of securities should be disclosed in a footnote. Any registrant electing to

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show the ratio of earnings to fixed charges, in accordance with this instruction, shall file as an exhibit a statement setting forth in reasonable detail the computations of such ratios. For the purpose of this exhibit and the pro forma ratio referred to above, an assumed maximum interest rate may be used on securities as to which the interest rate has not yet been fixed, which assumed rate should be shown.

5. In connection with any unaudited summary for an interim period or periods between the end of the last fiscal year and the balance sheet date, a representation should be made in a footnote that all adjustments necessary to a fair statement of the results for such interim period or periods, have been included. In addition there should be furnished in such cases, as supplemental information but not as a part of the registration statement, a letter describing in detail the nature and amount of any adjustments, other than normal recurring accruals, entering into the determination of the results shown.

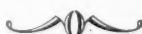
Our readers may observe that there are similarities between the proposal and the requirements for a summary of earnings included in a registration statement on Form S-9—particularly in Instruction 4 dealing with the optional showing of the ratio of earnings to fixed charges. In a Form S-9 filing this ratio must be shown.

A more important change is the one relating to figures for any period between the end of a fiscal year and the date of the latest balance sheet filed. Where such interim figures are required to be furnished, there would also have to be furnished the data for the corresponding period of the preceding fiscal year. Although this is a new proposal, in a sense it is not new. We have known the SEC to request figures of the corresponding period in the preceding year where it appeared

that the earnings of the most recent interim period are influenced by seasonal or other unusual characteristics. Thus, the Commission's proposal would formalize what is at present an informal requirement which is invoked whenever it appears to be necessary.

In lieu of two sets of interim figures it will be noted that utility companies would have the option of furnishing a summary for the twelve months ending on the interim date. This statement would, of course, eliminate the seasonal factor which is present to some degree in the business of some utility companies.

Instruction 5 to the proposal also formalizes what is presently an administrative requirement. Readers of this column should know that as to any unaudited interim figures the registrant must represent that such figures include all adjustments necessary for a fair presentation of the results for the period. In addition, the registrant must furnish, as supplemental information and not as part of the registration statement, a letter to the SEC describing in detail all the adjustments included in the interim figures other than normal recurring accruals. This department has always felt that the Commission's requirements should, whenever possible, be a part of the registration forms and instructions. Regardless of how we feel about the present requirement, we are glad to have it incorporated in the proposed form. In that way an accountant participating in a registration engagement would know of the SEC's requirement from reading the form and instructions and would not learn of this requirement for the first time when the Commission's deficiency letter is received.



# Payroll Tax Notes

Conducted by SAMUEL S. RESS

## Unemployment Insurance—Significance of the 1955 Unemployment Insurance Amendments to Accountants and Employers

In the "Payroll Tax Notes" column last month a number of measures which had been passed by the State Legislature relating to unemployment insurance taxation were discussed. The bill which would have reduced the qualifying period for merit rating purposes from 14 calendar quarters to 4 quarters, so that those employers who had been covered by our state unemployment insurance law for the shorter period might be able to benefit taxwise sooner, was vetoed by the Governor, even though a new provision in the Federal unemployment tax law permitted the shorter qualifying period by the states.

### Unemployment Insurance Amendment Timetable

Industrial Commissioner Isadore Lubin of the New York State Department of Labor has issued a special bulletin regarding the 1955 amendments which is of special interest to accountants and employers. The unemployment insurance amendment timetable sets forth the effective dates of the principal changes in the law as follows:

1. *April 25, 1955.* Weekly earnings limit for partially employed who have less than four days work a week raised from \$30 to \$36.

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Dr. Ress is a member of the Society's Committee on New York State Taxation and Chairman of the Sub-Committee on Unemployment Insurance.

2. *July 4, 1955.* Maximum benefit rate raised from \$30 to \$36 for all new claimants starting benefit years.
3. *January 1, 1956.* Coverage extended to 150,000 workers in 50,000 firms that have three or more employees on any day; and to household employees if four or more are employed on any day.
4. *January 1, 1957.* Coverage extended to 200,000 employees in 100,000 firms that have two or more employees on any day.

"Other changes benefiting wage-earners are:

1. *March 26, 1955.* Coverage of custodial engineers in Buffalo schools.
2. *April 21, 1955.* Coverage of workers in State Armories and State Guard staff employed by State Division of Military and Naval Affairs.
3. *July 1, 1955.* Coverage extended to all State employees in classified Civil Service.
4. *September 1, 1955.* State will pay benefit claimant's counsel fees and printing costs on appeals to the Courts if Unemployment Insurance Appeal Board decision favored claimant; except that if claimant appeals to Court of Appeals, allowance depends on Court finding appeal was meritorious."

Commissioner Lubin points up the significant changes in these words:

"... Under one of the 1955 amendments to the State Unemployment Insurance Law, any New York employer, no matter how small his firm, could conceivably become liable for unemployment taxes in 1956.

The actual text of the change provides that firms with three employees shall become liable for tax payments as of January 1st, 1956; firms with two employees will become liable one year later, on January 1st, 1957. (No provision was made for extending coverage to one-employee firms.)

"Despite this time-table for limited and gradual extension of coverage, some firms with two employees or even one employee may become liable for taxes in 1956, since an employer who has three men on his payroll *on any day* in '56 immediately becomes a subject employer. Previously, liability had been incurred only after employment of four employees on 15 different days.

## Payroll Tax Notes

"For example, assume a dry cleaning shop has a regular staff of two, but on the Friday before the long Fourth of July weekend an extra presser is hired—for the day—to get all the work out.

"The dry cleaner immediately becomes a liable employer.

"And once in the system, he will not be able to apply for a termination of his coverage until and unless he has had only one man in his employ for a full calendar year.

"This is a second important change: tightening of the provisions for ending liability. Assume an employer laid off two of his four employees in 1954 and all through 1955 has no more than two men on payroll. If he files an application in the fourth quarter of this year to terminate his liability in '56, his request would be approved. However, under terms of a new amendment, if he waits until '56 before requesting termination, his application would not be approved—despite the fact that coverage of firms with two employees will not be effective until 1957.

*"The only way a subject employer can terminate liability after January 1st, 1956 is to show, at the time he requests termination, that he has had no more than one employee on his payroll since the beginning of the previous calendar year. (If application is made during the fourth quarter of a year, however, the employer need only show that he has not employed more than one worker at any time during that year.)*

"Most employees of two and three workers will be advised of their exact status under the changed law by the end of this year. The Division of Employment has already requested and received complete records on all New York employers filing fourth quarter '54 social security returns. Firms showing two or three employees on this report will be segregated from the rest. The three-employee firms will be advised of their liability and assigned a registration number; the two-employee firms will be advised of their potential liability in '56 should they add another employee and of their automatic liability effective January 1st, 1957. All this will be done later this year.

"Late in 1956, working from social security returns for the fourth quarter of 1955, the Division will notify the two-employee firms that they have been assigned registration numbers for their pending entrance into the system, and the one-employee firms will be advised of their potential liability should they hire another worker on any day after January 1st, 1957.

"Business expansion and reduction since the fourth quarter of '54, of course, will

remove some firms from the "2 to 3" category listed in the social security report and will bring other firms into that category. Through Internal Revenue cooperation and other sources, however, the Division hopes to be able to have a relatively accurate and complete list of 2 and 3 employee firms and to have notified most affected firms of their pending liability by the end of the year.

"Failure to receive notice will not relieve employers of the obligation of declaring their liability and paying the tax.

"Employers who have household employees in their private homes should also take note of another significant change in coverage. Effective January 1st, 1956, any person employing four persons in personal or domestic service in the home *on any day in the year* is liable for unemployment tax payments. Nor can he leave the system until he meets the same conditions for termination of liability that all other employers are asked to meet . . . no more than one worker for a full calendar year.

"All told, it is expected that the addition of firms with 3 employees will bring some 50,000 employers and 150,000 workers into the system in '56. When the two-employee firms are covered in '57, it is anticipated that another 100,000 employers and 200,000 workers will be added to the system.

"This will bring total insured non-farm employment in the State close to the 6 3/4 million mark. Still uncovered will be the 150,000 firms having only one employee.

"Another change in the law of particular interest to employers, controllers and accountants is the setting up of a graded scale of subsidiary contributions to the General Account of the Unemployment Trust Fund.

"In essence, the General Account is a bookkeeping device for writing off any negative balances in individual employer accounts. A negative balance results when a firm's former employees draw out more in benefits than the firm has paid in taxes.

"To give such an employer a fresh start, the law adjusts his balance to zero and requires him to pay tax at 2.7% of payroll for at least the next three years. The deficit in his account is then debited to the General Account.

"The General Account is credited with money as well as debited. It "takes in" the interest on the Unemployment Trust Fund, lapsed employer account balances, recovered benefit overpayments and other minor items.

"Subsidiary contributions are required of all liable employers when the General Account balance is considered unsatisfactory. Until now, the subsidiary contribution rate has been:

- 1) An extra  $\frac{1}{2}$  per cent payroll tax if on any June 30 the balance is below  $1\frac{1}{2}\%$  of the previous year's payrolls.
- 2) An extra 1 per cent payroll tax if the balance is less than  $\frac{3}{4}$  of 1% of payrolls.

"The new amendment provides for graduated contributions (when contributions are necessary), by tenths, from 1/10 of 1% of payrolls to a full 1% of payrolls depending on the condition of the General Account.

"Other unemployment insurance changes of interest are the increase in benefit rates and the rise in the earnings limit for partial unemployment.

"To maintain unemployment insurance benefit rates at approximately one-half normal earnings during this day of rising wages, the schedule of benefit rates has been revised. The upward adjustment in rates will affect claimants with average weekly wages of \$23 and over. The new top rate of \$36 will go to claimants whose wages averaged at least \$70 a week.

"These revised benefit rates apply to all new benefit years beginning on and after July 4, 1955. The rates for claimants already receiving benefits will not be adjusted.

"The earnings limit on partial unemployment has been raised from \$30 to \$36. This was effective as of April 26. A worker who is employed 1, 2 or 3 days in a week and earns no more than \$36 is entitled to an unemployment check for part of his regular rate. The size of his check will depend, as in the past, on the number of days he worked; one day, a payment at  $\frac{3}{4}$  his regular rate; 2 days, a  $\frac{1}{2}$  payment; and 3 days, a  $\frac{3}{4}$  payment."

#### **Unemployment Insurance Benefit Controls Are Needed**

More attention will have to be devoted to unemployment insurance

claims and controls if benefits at the new increased rates are to be confined to those actually entitled to them. Employers are going to find that the increased benefit rates will increase their unemployment insurance tax costs by at least 20 per cent unless immediate steps are introduced to avoid unnecessary claims being charged against their accounts. It may be advisable and worthwhile to call upon expert counsel in the field of unemployment insurance for the purpose of establishing an effective system of control to prevent rates from skyrocketing.

#### **Counsel Fee Amendment Inquiry**

The amendment to the law regarding the counsel fee allowance which goes into effect on September 1st, 1955, was the subject of an inquiry addressed to *The New York Certified Public Accountant*. The writer of the letter stated: ". . . Article 18, Title 3, section 538, as amended by the laws of 1955, appears to represent another step by the lawyers to strengthen their claims insofar as their profession is concerned. . . ."

This amendment deals only with the representation of benefit claimants before the Appellate Division and the Court of Appeals and as far as the writer knows no segment of the accounting profession has urged that public accountants should be permitted to represent clients in the courts, and especially not in the higher appellate courts of the state.

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